SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1928

No. 481

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF KENTUCKY, PETITIONER

vs.

A. J. A. ALEXANDER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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1 In United States District Court for the Western District of Kentucky

[Caption omitted.]

A. J. A. ALEXANDER, PLAINTIFF

vs.

ROBT. H. LUCUS, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT of Kentucky, defendant

Petition

Filed May 27, 1924

The plaintiff, A. J. A. Alexander, says he is a citizen of Kentucky, and resides at Spring Station in the eastern district of Kentucky.

Plaintiff says the defendant, Robert H. Lucas, is the duly acting and qualified collector of internal revenue for the district of Kentucky, and has been since the 24th day of May, 1921, and is a resident of Louisville, Kentucky.

The plaintiff says that for the year of 1919 and before March 15, 1920, he filed with the collector of internal revenue for the district of Kentucky his income-tax return, and showed thereon the following income and deductions:

2

Farming	$22,469.00
Salary	2,000.00
Security Trust Co.	5,200.00
Rents	28,652.34
Income ins. policy	00
Int. on bonds	
Foreign countries	163.79
Dividends on insurance policies	17,290.35
Dividends	2,997.06
	$78,773.23
Deductions:	
Interest paid	1,005.00
Taxes paid	237.67
Contributions	11,560.35
	$12,803.02
Net income	$65,880.21

Plaintiff says that on the above income he claimed a personal exemption of $1,400.00, and paid taxes thereon in the sum of $13,155.52.

Plaintiff says that there was reported in the above income as dividends on a paid-up life insurance $17,290.35.

Plaintiff says on the 19th day of May, 1899, he procured from the New York Life Insurance Company two life policies of $50,000.00 each, maturing on May 19, 1919; that said policies provided for the payment of an annual premium on each of them of $3,905.00 for a period of ten years.

Plaintiff says that said premiums were paid commencing on the 19th day of May, 1899, and continuing to and including May 19, 1918, the total premiums paid being $78,100.00.

Each of the above policies had the following provisions as to the maturity thereof, and certain option to be exercised at the end of the premium-paying period:

"This insurance bond participates in surplus as hereinafter provided, but no dividend shall be apportioned to it before the end of the accumulation period. If the insured elects to continue this insurance bond beyond the accumulation period, under one of the two accumulation benefits first named below, no further dividend shall be apportioned to it before the end of each period of five years thereafter.

3 "The accumulation period of this insurance bond ends on the nineteenth day of May in the year nineteen hundred and nineteen. If the insured is living, and if the premiums have been duly paid to that date, and not otherwise, the company will then apportion a dividend to the insured, who shall have the option of continuing or discontinuing this insurance bond under one of the following four accumulation benefits:

"(1) Receive an income of two thousand dollars and ——— cents per annum during life (being equal to four per cent on the initial amount of the insurance ($50,000), the first payment to be made on the nineteenth day of May, nineteen hundred and twenty, and receive the dividend converted into a life annuity, payable with the income as above, and continue this insurance bond without further payment of premiums (evidence of good health will not be required, or

"(2) Receive the dividend in cash, and receive an income for life payable as specified in the 'first benefit' and continue this insurance bond without further payment of premiums (evidence of good health will not be required) or

"(3) Receive the entire cash value, as stated below, converted into an annual income during the life of the insured, payable as provided in the 'first benefit' which income the company guarantees shall be not less than thirty-four hundred and seventy-four dollars and ——— cents and discontinue this insurance bond, or

"(4) Receive the entire cash value, as stated below, in cash, and discontinue this insurance bond.

"The company guarantees that the entire cash value of this insurance bond at the end of the accumulation period shall be fifty thousand dollars, and in addition the cash dividend then apportioned by the company. At the end of the accumulation period the company will send the insured a written statement setting forth the results under each of the above accumulation benefits, and if the insured shall fail at that time to notify the company which benefit has been selected, the first benefit shall be considered selected.

"The accumulation period of this bond ends on the 19th day of May in the year 1919, if the insured is living and the premiums have been duly paid to that date, and not otherwise."

4 Plaintiff says he is unable to file copies of the above policies, because same have been surrendered to the insurance company and photostatic copies thereof are in the possession of the Commissioner of Internal Revenue.

Plaintiff says when said policies matured on May 19, 1919, there was paid to him by the insurance companies $120,797.00.

Plaintiff says that on May 19, 1922, the Commissioner of Internal Revenue, by letter, notified him that said commissioner disagreed with him as to the net income arising from the proceeds of the above policy and determined that the taxable income arising therefrom was $42,697.00, instead of $17,290.35, as reported by the plaintiff in his income-tax return.

Plaintiff says in determining the March 1, 1923, value of his insurance policies, he used a compound rate of interest of .0283 on the combined annual premium on both policies, to wit, $7,810.00, and this method showed a value March 1, 1913, of $103,560.65.

Plaintiff says the Commissioner of Internal Revenue treated the March 1, 1913, value of the policies as the sum of the premiums paid, to wit, $78,100.00, and increased the taxable net income of the plaintiff as heretofore stated.

Plaintiff says that the policies above described were participating policies, and there was added to each of them annual accumulations from date of issue to date of maturity, but under the provisions of said policies the accumulations could not be withdrawn until the maturity of said policies.

Plaintiff says that the policies above referred to were worth on March 1, 1913, $103,506.65, and the Commissioner of Internal Revenue was in error in valuing said policies on said date at $78,100.00.

Paragraph 2. Plaintiff says on the 2nd day of December, 1902, A. J. Alexander, his father, died testate and left surviving him five children, two of whom subsequently died. All of said children were the beneficiaries under said will.

Plaintiff says under the tenth clause of said will a trust estate was created in the following language:

"All other property of every description which I may own at the time of my death, real, personal, and mixed, except that specifically devised by this will, including one-half of the rents from the Ashland Block and Ashland Annex properties referred to in the eighth

5 clause of this will, and including also all of the income from my stock in the Ashland Block and Ashland Annex Company, which stocks are disposed of in the ninth clause of this will and any property or estate that may hereafter fall into my estate by reversion or otherwise, I give to my executors with which to create a sinking fund to meet any and all obligations on my estate, such as debts, unexecuted contracts, legacies, and bequests, and also to raise the fund of five hundred thousand dollars hereinafter mentioned.

The funds thus provided to be invested and reinvested by my executors in their discretion, and as occasion may require to the satisfaction of the aforesaid obligations. And my executors are hereby authorized to make contracts, create debts, negotiate loans, sell and convey any property that may come into their hands under this clause and to invest and reinvest the proceeds, in their discretion. And when all liabilities against my estate have been fully paid and satisfied, all the remainder of the funds coming into their hands under this clause to be invested and reinvested in such properties and such securities as they may select for the purpose until the sum of five hundred thousand dollars has been realized, when the said sum shall be paid over and delivered to a trustee, or trustees, selected by them for the purpose, who shall hold the same in trust, investing and reinvesting the same for the purposes of income, for the use and benefit of my five children in equal shares, the interest and income on which to be paid semiannually, to my said children during their lives, the interest of any child or children that may die leaving descendents to be paid over to such descendents, per stirpes, and the interest of any child or children dying without descendents living at the time of his or her death, to pass to and be paid to my surviving children and to the descendents of any that may have died leaving descendents, per stirpes, until the death of all my children, at which time the said principal sum of five hundred thousand dollars is to be paid over and delivered to the descendents of my children then living per stirpes. The trustee or trustees are to be appointed by the proper court and to execute bonds with security as required by law in such cases.

When the aforesaid fund of five hundred thousand dollars
6 has been accumulated and placed in the hands of the trustee or trustees as hereinbefore directed, then all the restrictions and limitations placed by this will upon the Ashland Block and Ashland Annex properties devised by this will to my children and their descendents shall be immediately removed, and the said properties and stocks conveyed in the ninth clause shall thenceforth be owned, held, used, and enjoyed by my wife and children share and share alike, one-sixth to each and the descendents per stirpes, freed from any and all limitations or trusts created by this will, and may be controlled or disposed of by them at their pleasure."

Plaintiff says the Security Trust Company, of Lexington, Kentucky, a corporation incorporated under the laws of the State of Kentucky, with power to contract and be contracted with, to sue and be sued, and to perform the duties of a trustee, was appointed trustee under said will and paid to him during the year of 1919, $5,200.00, and that said sum was included in his taxable income for the year 1919, and the tax paid thereon.

Plaintiff says that said sum was a gift and is not taxable.

Plaintiff says that his true gross income and deductions for the year 1919 were as follows:

Gross Income

Income from farming		$61,416.45
Deductions:		
Labor	87,195.42	
Material & supplies	12,154.87	
Merchandise bought for resale	32,972.40	
General expense	2,075.75	
Inventory at beginning of year	36,980.00	
	891,378.44	
Less inventory at end of year	59,365.00	
	832,013.44	
Other deductions:		
Salaries	3,612.78	
Rent	24.00	
Interest	780.67	
Taxes	1,809.00	
Repairs	650.50	
		38,947.39
Net income from farming		822,469.06
7 Salaries		2,000.00
Income from rents	45,842.51	
Deductions:		
Repairs, wear and tear	3,474.37	
Interest	4,588.33	
Taxes	4,548.15	
Other expenses	7,312.41	
	19,913.86	
Income from rents		25,928.65
Income from insurance policies subject to normal tax		21,000.00
Dividends on stock of foreign corporation		163.79
Dividends on insurance policies		2,807.06
Dividends from other corporations		4,337.11
Income from all sources		$79,796.30
Deductions:		
Interest paid	1,065.00	
Taxes paid	237.67	
Contributions	11,774.04	
		13,076.71
Taxable net income		$66,719.59

Plaintiff says the tax due on this sum was $14,539.05.

Plaintiff says the Commissioner of Internal Revenue assessed and certified for collection to the defendant, Robert H. Lucas, income taxes against him for the year of 1919 in the sum of $26,579.94, and on October 26, 1923, in order to avoid the imposition of penalties and the seizure of his property, to satisfy said taxes, he paid under protest to the defendant, Robert H. Lucas, the taxes demanded, and on said date he filed with the defendant, Robert H. Lucas, a claim for refund in the sum of $12,441.60, said claim being immediately forwarded to the Commissioner of Internal Revenue for his consideration.

Plaintiff says that notwithstanding the fact that the Commissioner of Internal Revenue has had before him for his consideration said claim for refund for more than six months, he has declined and failed to either approve or reject same.

Wherefore plaintiff prays judgment against the defendant, Robert H. Lucas, collector of internal revenue, for the sum of $12,040.89, with six per cent interest thereon from October 26, 1923, until paid.

BECKHAM, HAMILTON & BECKHAM,
Attorneys for Plaintiff.

8 The plaintiff, A. J. A. Alexander, says the statements of the foregoing petition are true as he verily believes.

A. J. A. ALEXANDER.

Subscribed and sworn to before me this 26 day of May, 1924.

[SEAL.] S. A. WALLACE,
Notary Public, Fayette Co., Ky.

In United States District Court

Amended petition

Filed November 6, 1924

Paragraph 1. Comes the plaintiff by leave of court and for amendment his petition heretofore filed says:

The plaintiff, A. J. A. Alexander, says he is a citizen of Kentucky, and resides at Spring Station in the eastern district of Kentucky.

Plaintiff says the defendant, Robert H. Lucas, is the duly acting and qualifying collector of internal revenue for the district of Kentucky, and has been since the 24th day of May, 1921, and is a resident of Louisville, Kentucky.

The plaintiff says that for the year of 1919 and before March 15, 1920, he filed with the collector of internal revenue for the district of Kentucky his income tax return, and showed thereon the following income and deductions:

Farming	$22,439.69
Salary	2,000.00
Security Trust Co.	5,200.00
Bonds	28,632.34
Income ins. policy	60
Int. on bonds	
Foreign countries	163.79
9 Dividends on insurance policies	17,290.35
Dividends	2,197.66
	78,773.23
Deductions:	
Interest paid	1,065.00
Taxes paid	257.67
Contributions	11,070.92
	12,893.62
Net income	65,880.21

Plaintiff says that on the above income he claimed a personal exemption of $1,400.00, and paid taxes thereon in the sum of $13,135.32.

Plaintiff says that there was reported in the above income as dividends on the life-insurance policies hereinafter described $17,290.35.

Plaintiff says on the 19th day of May, 1899, he procured from the New York Life Insurance Company two life-insurance policies of $50,000.00 each, maturing on May 19, 1919; that said policies provided for the payment of an annual premium on each of them of $3,905.00 for a period of ten years.

Plaintiff says that said premiums were paid commencing on the 19th day of May, 1899, and continuing to and including May 19, 1908, the total premiums paid being $78,100.00.

Each of the above policies had the following provisions as to the maturity thereof, and certain options to be exercised at the end of the premium-paying period:

"This insurance bond participates in surplus as hereinafter provided, but no dividend shall be apportioned to it before the end of the accumulation period. If the insured elects to continue this insurance bond beyond the accumulation period under one of the two accumulation benefits first named below, no further dividend shall be apportioned to it before the end of each period of five years thereafter.

"The accumulation period of this insurance bond ends on the nineteenth day of May in the year nineteen hundred and nineteen. If the insured is living, and if the premiums have been duly paid to that date and not otherwise, the company will then apportion a dividend to the insured, who shall have the option of continuing or discontinuing this insurance bond under one of the following four accumulation benefits:

"(1) Receive an income of two thousand dollars and ——— cents per annum during life (being equal to four per cent on the initial amount of the insurance ($50,000), the first payment to be made on the nineteenth day of May, nineteen hundred and twenty, and receive the dividend converted into a life annuity, payable with the income as above, and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or

"(2) Receive the dividend in cash and receive an income for life, payable as specified in the 'first benefit' and continue this insurance bond without further payment or premiums (evidence of good health will not be required); or

"(3) Receive the entire cash value, as stated below, converted into an annual income during the life of the insured, payable as provided in the 'first benefit,' which income the company guarantees shall be not less than thirty-four hundred and seventy-four dollars and ——— cents and discontinue this insurance bond; or

"(4) Receive the entire cash value, as stated below, in cash and discontinue this insurance bond.

"The company guarantees that the entire cash value of this insurance bond at the end of the accumulation period shall be fifty thousand dollars, and in addition the cash dividend then apportioned

by the company. At the end of the accumulation period the company will send the insured a written statement setting forth the results under each of the above accumulation benefits, and if the insured shall fail at that time to notify the company which benefit has been selected the first benefit shall be considered selected.

"The accumulation period of this bond ends on the 19th day of May in the year 1919 if the insured is living and the premiums have been duly paid to that date and not otherwise."

Plaintiff says he is unable to file copies of the above policies, because same have been surrendered to the insurance company and photostatic copies thereof are in the possession of the Commissioner of Internal Revenue.

11 Plaintiff says when said policies matured on May 19, 1919, there was paid to him by the insurance company $120,797.00.

Plaintiff says that on May 19, 1922, the Commissioner of Internal Revenue, by letter, notified him that said commissioner disagreed with him as to the net income arising from the proceeds of the above policies and determined that the taxable income arising therefrom was $42,697.00 instead of $17,290.35, as reported by the plaintiff in his income-tax return.

Plaintiff says in determining the March 1, 1913, value of his insurance policies, he used a compound rate of interest of .0283 on the combined annual premium on both policies, to wit, $7,810.00, and this method showed a value March 1, 1913, of $103,506.65.

Plaintiff says the Commissioner of Internal Revenue treated the March 1, 1913, value of the policies as the sum of the premiums paid, to wit, $78,100.00, and increased the taxable net income of the plaintiff as heretofore stated.

Plaintiff says that the policies above described were participating policies, and there was added to each of them annual accumulations from date of issue to date of maturity, but under the provisions of said policies the accumulations could not be withdrawn until the maturity of said policies.

Plaintiff says that the policies above referred to were worth on March 1, 1913, $115,511.00 and the Commissioner of Internal Revenue was in error in valuing said policies on said date of $78,100.00.

Paragraph 2. Plaintiff says on the 2nd day of December, 1902, A. J. Alexander, his father, died, testate and left surviving him five children, two of whom subsequently died. All of said children were beneficiaries under said will.

Plaintiff says under the tenth clause of said will a trust estate was created in the following language:

"All other property of every description which I may own at the time of my death, real, personal, and mixed, except that specifically devised by this will, including one-half of the rents from the Ashland Block and Ashland Annex, properties referred to in the eighth clause of this will, and including also the income from my stock in the Ashland Block Association and the Ashland Annex Company,

which stocks are disposed of in the ninth clause of this will,
12 and any property or estate that may hereafter fall into my estate by reversion or otherwise, I give to my executors with which to create a sinking fund to meet any and all obligations on my estate, such as debts, unexecuted contracts, legacies, and bequests, and also to raise the fund of five hundred thousand dollars hereinafter mentioned. The funds thus provided to be invested and reinvested by my executors in their discretion, and as occasion may require to the satisfaction of the aforesaid obligations. And my executors are hereby authorized to make contracts, create debts, negotiate loans, sell and convey any property that may come into their hands under this clause, and to invest and reinvest the proceeds, in their discretion. And when all liabilities against my estate have been fully paid and satisfied, all the remainder of the funds coming into their hands under this clause to be invested and reinvested in such properties and such securities as they may select for the purpose until the sum of five hundred thousand dollars has been realized, when the said sum shall be paid over and delivered to a trustee or trustees selected by them for the purpose, who shall hold the same in trust, investing and reinvesting the same for the purpose of income, for the use and benefit of my five children in equal shares, the interest and income on which to be paid semiannually to my said children during their lives, the interest of any child or children that may die leaving descendants to be paid over to such descendants, per stirpes, and the interest of any child or children dying without descendants living at the time of his or her death to pass to and be paid to my surviving children and to the descendants of any that may have died leaving descendants, per stirpes, until the death of all my children, at which time the said principal sum of five hundred thousand dollars is to be paid over and delivered to the descendants of my children then living, per stirpes. The trustee or trustees are to be appointed by the proper court and to execute bonds with security as required by law in such cases.

"When the aforesaid fund of five hundred thousand dollars has been accumulated and placed in the hands of the trustee or trustees as hereinbefore directed, then all the restrictions and limitations placed by this will upon the Ashland Block and Ashland Annex, properties devised by this Will to my children and their descend-
13 ants, shall be immediately removed and the said properties and stocks conveyed in the ninth clause shall thenceforth be owned, held, used, and enjoyed by my wife and children share and share alike, one-sixth to each and the descendants, per stirpes, freed from any and all limitations or trusts created by this will, and may be controlled or disposed of by them at their pleasure."

A copy of said will is filed herewith as part hereof marked Exhibit "A."

Plaintiff says the Security Trust Company, of Lexington, Kentucky, a corporation incorporated under the law of the State of Kentucky, with power to contract and be contracted with, to sue and be

sued, and to perform the duties of a trustee, was appointed trustee under said will and paid to him during the year of 1919, $5,200.00, and that said sum was included in his taxable income for the year 1919, and the tax paid thereon.

Plaintiff says that said sum was a gift and is not taxable.

Plaintiff says in his original income-tax return he reported in Schedule E 24,250.00 as rentals from the Ashland Block Association, Chicago, Illinois.

Plaintiff says that said income was one-third of the rentals paid by the Ashland Block Association which was his proportionate part. He says he failed to deduct from said rentals reasonable and fair depreciation to which he was entitled, which sum was $3,333.33, and that his net income from rents should have been $25,319.01 instead of $28,652.34.

Plaintiff says that his true gross income and deductions for the year 1919 were as follows:

Gross Income

Income from farming			$61,416.48
Deductions:			
Labor		$7,195.42	
Material and supplies		12,154.87	
Merchandise bought for resale		32,972.40	
General expense		2,075.75	
Inventory at beginning of year		36,980.00	
		$91,378.44	
Less inventory at end of year		59,365.00	
		$32,013.44	
14 Other deductions:			
Salaries		3,612.78	
Rent		24.00	
Interest		780.67	
Taxes		1,923.00	
Repairs		656.50	
			38,947.39
Net income from farming			$22,469.09
Salaries			7,000.00
Income from rents		45,842.51	
Deductions:			
Repairs, wear & tear	$4,084.61		
Interest	4,583.33		
Taxes	4,343.15		
Other expenses	7,312.41		
		20,323.50	
Income from rents			$25,519.01
Dividends on stock of foreign corporations			165.79
Dividends on insurance policies			5,286.00
Dividends from other corporations			2,007.05
			$59,295.35
Deductions:			
Interest paid		1,085.00	
Taxes paid		237.67	
Contributions		8,520.93	
			9,842.60
Taxable net income			48,252.95

Plaintiff says the tax due on this sum was $7,997.11.

Plaintiff says that at the time he filed his original return he paid to the collector of internal revenue $13,135.52, and in October, 1923, the Commissioner of Internal Revenue certified to the defendant Robert H. Lucas, collector of internal revenue for the district of Kentucky an additional assessment of income taxes for the year 1919 of $11,334.17, said assessment being caused by the act of the Commissioner of Internal Revenue in valuing the income received on the insurance policies as above set out.

Plaintiff says on October 26, 1923, in order to avoid the imposition of penalties and the seizure of his property to satisfy said taxes he paid to the defendant under protest the said additional assessment, to wit, $11,334.17.

Plaintiff says on October 26, 1923, he filed with the defendant
15 a claim for refund of the taxes erroneously assessed against and collected from him and for such greater amount as was legally refundable.

Plaintiff says that said claim for refund was immediately forwarded to the Commissioner of Internal Revenue for his consideration, and notwithstanding this fact the said commissioner has declined, failed, and refused to either refund the taxes paid or to reject the claim filed.

Plaintiff says that the defendant Robert H. Lucas, collector of internal revenue, is truly and justly indebted to him in the sum of $11,334.17 for income taxes erroneously assessed and paid under protest for 1919 and the United States is truly and justly indebted to him in the sum of $5,138.41 for income taxes erroneously paid by plaintiff under a mistake of law at the time he filed his original income-tax return for 1919.

Plaintiff says he has set out his gross income and deductions in full in order that his true tax liability may be determined, but that he is only seeking to recover in this action $11,334.17, the amount of taxes paid under protest to the defendant, and has instituted separate action against the United States for $5,138.41 for the taxes erroneously paid but not under protest for 1919.

Wherefore plaintiff prays judgment against the defendant, Robert H. Lucas, collector of internal revenue, for $11,334.17, with interest from October 26, 1923, until paid, and for his cost and all proper relief.

BECKHAM, HAMILTON & BECKHAM,
Attorneys for Plaintiff.

The plaintiff, A. J. A. Alexander, says the statements of the foregoing petition are true, as he verily believes.

A. J. A. ALEXANDER.

Subscribed and sworn to before me this the 18 day of Oct. 1924.

JNO. S. YELLMAN,
Notary Public.

Notary public, Fayette Co., Ky. My commission expires Mar. 20th, 1925.

16 *Exhibit with petition*

Filed Dec. 30, 1924

New York Life Insurance Company insurance bond guaranteed interest. Life of Alexander J. A. Alexander. Policy No. 950777. Amount, $50,000. No. 950777. $50,000.

New York Insurance Company by this insurance bond, with guaranteed interest, agrees to pay fifty thousand dollars to the insured's executors, administrators, or assigns, or to such other beneficiary as may be designated by the insured as hereinafter provided, at the home office of the company, in the city of New York, immediately upon receipt and approval of proofs of the death of Alexander J. A. Alexander, of ———, in the county of Woodford, State of Kentucky (herein called the insured).

Premium refund.

And the company further agrees to pay in addition to the face amount of this insurance bond, as shown on the next page hereof, if the death of the insured shall occur before the nineteenth day of May, nineteen hundred and nineteen, the addition being equal to the excess over the face amount of the total amount of premiums paid (taken at the tabular annual rate), with interest compounded at the rate of four per cent per annum from the date of each payment to the date of death.

Age 34.

And the company further agrees that this insurance bond shall be incontestable after it has been in force one full year if the premiums have been fully paid.

Annual premium.

This contract is made in consideration of the written application of the insured, which is a part of this contract, and in further consideration of the sum of thirty-nine hundred and five dollars and no cents, to be paid in advance, and of the payment of a like sum on the nineteenth day of May in every year thereafter during the continuance of this insurance bond until ten full years' premiums shall have been paid.

$3,905.

The special advantages, benefits, and provisions printed or written by the company on the following pages

17 are conditions precedent and are a part of this contract as full as if they were recited at length over the signatures hereto affixed.

Examined. H.H. Hall.

In witness whereof the New York Life Insurance Company has caused this contract to be signed by its president, secretary, countersigned by its registrar or assis-

ant registrar, and delivered this fifth day of June one thousand eight hundred and ninety-nine.

(Signed) JOHN A. MCCALL,
President.

(Signed) CHARLES C. WHITNEY,
Secretary.

(Signed) WM. A. FERREIA,
Assistant Registrar.

Insurance bond with guaranteed interest and annual loans, beneficiary clause, 20-yr. accumulation. 98-284. No. 950778. $5000

BENEFIT AND PROVISIONS

1. LOANS

With interest at the rate of five per cent per annum.

The company will make advances to the insured as loans on this insurance bond within the month of grace allowed in payment of premiums, on application to the home office, at the third or any subsequent anniversary of the insurance, within the accumulation period under the terms of the company's loan agreement then in use and the following conditions:

First. That premiums have been paid in full to the time when the loan is made, including the premium for the entire insurance year, then beginning.

Second. That the amount loaned at any time shall be such as the insured may desire, not to exceed the sums shown in the table on the preceding page. The amount of any loan shall include any previous loan then unpaid.

Third. That this insurance bond shall be duly assigned to the company as collateral security for the loan, and deposited at
18 the home office. A duplicate of the loan agreement, which is also a receipt for the bond, will be furnished to the insured.

Fourth. That interest in advance at the rate of five per cent per annum shall be paid on all loans from the date of the loan to the next anniversary of the insurance, and annually in advance thereafter, if the loans are renewed until they are paid off.

Fifth. That the loans shall be made for the period ending upon the next succeeding anniversary of the insurance, and may then be renewed simply by payment of the insurance premiums falling due and interest in advance, as above. Thus the loan may be renewed from year to year, at the option of the insured until the completion of the accumulation period.

By written notice to the company, the insured has charged the beneficiary of this policy to Kate Holloway Alexander, wife, or in the event of her prior death to insured's executors, administrators or assigns, November 25, 1918.

JOHN A. MCCALL,
2nd Vice-President.

2. NONFORFEITURE

This insurance bond can not be forfeited after it shall have been in force three full years, as hereinafter provided:

First. If any subsequent premium is not duly paid, this insurance will be endorsed for the amount of paid-up insurance specified in the table on the preceding page, less the value of any indebtedness on this bond, provided demand is made therefor with surrender of this bond within six months after such nonpayment, such paid-up insurance being payable either if the insured shall die before the nineteenth day of May, nineteen hundred and nineteen, or if the insured shall then be living; or, subject to the same conditions, this bond may be endorsed for the same amount of paid-up insurance, but payable at death only, with guaranteed annual income, beginning on the date specified in the first "accumulation benefit" on the preceding page equal to four per cent of the total amount of premiums paid, taken at the tabular annual rate; or,

19 Second. If any subsequent premium is not duly paid, and if this insurance bond is not surrendered as provided in the preceding clause, the insurance under this bond will, after the repayment of any indebtedness, be extended with request or demand therefor for the amount of fifty thousand dollars during the term provided in the table on the preceding page, payable only if the insured dies within said term. At the end of said term the insurance shall cease and the amount provided in the last column in said table will become payable if the insured is then living.

Third. The insurance provided for in the two preceding clauses shall be based upon completed insurance years only and shall be subject to the conditions of this insurance bond without further payment of premiums and without loans, participation in surplus, or premium return.

3. GRACE IN PAYMENT OF PREMIUMS

A grace of one month will be allowed in payment of premiums after this insurance bond shall have been in force three months, subject to an interest charge at the rate of five per cent per annum for the number of days during which the premium remains due and unpaid. During the month of grace this insurance bond remains in force and the unpaid premium, which interest as above remains an indebtedness to the company, which will be deducted from the amount payable under this bond if the death of the insured shall occur during the month.

4. REINSTATEMENT IN EVENT OF LAPSE

This insurance bond will be reinstated on written application therefor within six months after nonpayment of any premium, subject to evidence of good health satisfactory to the company and payment of

premiums to date of reinstatement with interest at the rate of five per cent per annum.

5. CHANGE OF BENEFICIARY

The insured may at any time during the continuance of this insurance bond, provided the bond is not then assigned, change the beneficiary or beneficiaries by written notice to the company at the home office, accompanied by this bond; such change to take effect on the endorsement of the same on the bond of the company.

20 6. GENERAL REGULATIONS

No agent has power in behalf of the company to make or modify this or any contract of insurance, to extend the time for paying any premium, to waive any forfeiture, or to bind the company by making any promise or making or receiving any representation or information. These powers can be exercised only by the president, vice president, second vice president, actuary, or secretary of the company and will not be delegated.

All premiums are due and payable at the home office unless otherwise agreed in writing, but may be paid to agent producing receipts signed by the president, vice president, second vice president, actuary, or secretary and countersigned by both agents. If any premium is not paid on or before the day when due, this insurance bond shall become void and all payment previously made shall remain the property of the company, except as hereinbefore provided.

Proofs of death must be furnished to the company at the home office within one year after the death of the insured, which proofs shall comprise satisfactory statements establishing the claim. Such statements must comply fully with the company's forms in use at the time of the death of the insured. If it is found that the age of the insured was incorrectly stated in the application on which this insurance bond was issued, the amount payable under this insurance bond shall be such proportion of the amount of the bond as the premium paid bears to the required premium at the true age.

Any indebtedness to the company, including any balance of the current year's premium remaining unpaid, will be deducted in any settlement of this insurance bond or of any benefit thereunder.

Any assignment of this insurance bond must be made in duplicate and both sent to the home office, one duplicate to be returned by the company and the other to be returned. The company has no responsibility for the validity of any assignment.

21 SPECIAL ADVANTAGES—TABLE OF AMOUNTS PAYABLE IN EVENT OF DEATH DURING THE ACCUMULATION PERIOD, IF PREMIUMS ARE PAID IN FULL TO DATE OF DEATH

The amount payable to the insured, in event of death prior to May 19th, 1919, as specified on the face of the bond, will be as set forth in the following table:

Year	Amount payable	Year	Amount payable
First to tenth, inclusive	$50,000	Sixteenth	$61,650
Eleventh	50,700	Seventeenth	64,150
Twelfth	52,700	Eighteenth	66,700
Thirteenth	54,800	Nineteenth	69,330
Fourteenth	57,000	Twentieth	72,130
Fifteenth	59,300		

TABLE OF LOANS AND OF SURRENDER VALUES

In paid-up insurance or extended insurance, under the condition specified on the next page.

At end of—	Loans	Paid-up insurance	Surrender values (extended insurance for $50,000 for the term specified below, with cash, if then living)
3rd year	1,300	$15,000	17 years 0 months with $4,500 cash.
4th "	20,900	20,000	16 " 0 " " 11,700 "
5th "	15,900	25,000	15 " 0 " " 19,300 "
6th "	14,750	30,000	14 " 0 " " 25,250 "
7th "	20,100	35,000	13 " 0 " " 31,000 "
8th "	24,150	40,000	12 " 0 " " 36,500 "
9th "	28,000	45,000	11 " 0 " " 41,600 "
10th "	31,600		
11th "	35,700		
12th "	34,000		
13th "	37,100		
14th "	39,700		
15th "	42,200		
16th "	44,650		
17th "	46,900		
18th "	48,150		
19th "	49,300		
20th "	For special advantages at end of accumulation period, see accumulation benefits below.		

22 ACCUMULATION GUARANTEED

This insurance bond participates in surplus as hereinafter provided, but no dividend shall be apportioned to it before the end of the accumulation period. If the insured elects to continue this insurance bond beyond the accumulation period, under one of the two accumulation benefits first named below, no further dividend shall be apportioned to it before the end of each period of five years thereafter.

The accumulation period of this insurance bond ends on the nineteen day of May in the year nineteen hundred and nineteen, if the insured is living and if the premiums have been duly paid to that date, and not otherwise.

The company will then apportion a dividend to the insured, who shall have the option of continuing, or discontinuing, this insurance under one of the following:

FOUR ACCUMULATION BENEFITS

(1) Receive an income of two thousand dollars and no cents per annum during life (being equal to four per cent on the initial amount of the insurance ($50,000), the first payment to be made on the nineteenth day of May, nineteen hundred and twenty, and receive the dividend converted into a life annuity, payable with the income above, and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

(2) Receive the dividend, in cash, and receive an income for life payable as specified in the "first benefit" and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

(3) Receive the entire cash value, as stated below, converted into an annual income during the life of the insured payable as provided in the "first benefit," which income the company guarantees shall be not less than thirty-four hundred and seventy-four dollars and no cents, and discontinue this insurance bond; or,

(4) Receive the entire cash value, as stated below, in cash, and discontinue this insurance bond.

The company guarantees that the entire cash value of this insurance bond at the end of the accumulation period shall be fifty
23 thousand dollars, and in addition the cash dividend then apportioned by the company.

At the end of the accumulation period the company will send the insured a written statement, setting forth the results under each of the above accumulation benefits, and if the insured shall fail at that time to notify the company which benefit has been selected, the first benefit shall be considered selected.

State of Kentucky,

County of Jefferson, ss:

I, Mildred M. Spalding, a notary public, in and for the State and county aforesaid, do hereby certify that the foregoing is a full, true, and complete copy of insurance policy issued by the New York Life Insurance Company on the life of Alexander A. J. Alexander, No. 93777, dated the 5th day of June, 1899, as appears from a photostatic copy of the original of said policy in my possession.

In testimony whereof I have hereunto set my hand and affixed the seal of my office at the city of Louisville, Kentucky, this 24th day of December, 1924.

My commission expires June 21, 1925.

[SEAL.] MILDRED M. SPALDING,
Notary Public.

New York Life Insurance Company Insurance Bond with Guaranteed Interest Life of Alexander J. A. Alexander

Policy No. 950778. Amount $50,000

New York Life Insurance Company agrees to pay fifty thousand dollars to the insured's executors, administrators, or assigns, or to such other beneficiary as may be designated by the insured as hereinafter provided, at the home office of the company, in the city of New York, immediately upon receipt and approval of proofs of the death of Alexander J. A. Alexander, of ———, in the county of Woodford, State of Kentucky (herein called the insured).

Premium returns. 24 And the company further agrees to pay in addition to the face amount of this insurance bond, as shown on the next page hereof, if the death of the insured shall occur before the nineteenth day of May, nineteen hundred and nineteen, the additional being equal to the excess over the face amount of the total amount of premiums paid (taken at the tabular annual rate), with interest compounded at the rate of four per cent per annum from the date of each payment to the date of death.

Age 24. And the company further agrees that this insurance bond shall be incontestable after it has been in force one full year, if the premiums have been duly paid.

Annual premium. This contract is made in consideration of the written application of the insured, which is a part of this contract, and in further consideration of the sum of thirty-nine hundred and five dollars and no cents, to be paid in advance, and of the payment of a like sum on the nineteenth day of May in every year thereafter during the continuance of this insurance bond until ten full years' premiums shall have been paid.

$3,905. The special advantages, benefits, and provisions printed or written by the company on the following pages are conditions precedent and are a part of this contract as fully as if they were recited at length over the signature hereto affixed.

In witness whereof the New York Life Insurance Company has caused this contract to be signed by its president, secretary, countersigned by its registrar or assistant registrar, and delivered this fifth day of June, one thousand eight hundred and ninety nine. Examined. EH. Enll.

(Signed) JOHN A. McCALL,
President.

(Signed) CHARLES C. WHITNEY,
Secretary.

(Signed) WM. A. FERRIEA,
Assistant Registrar.

Insurance bond with guaranteed interest and annual loans, beneficiary clause, 20-yr. accumulation, 98-284.

25 BENEFITS AND PROVISIONS

1. LOANS

With interest at the rate of five per cent per annum.

The company will make advances to the insured as loans on this insurance bond within the month of grace allowed in payment of premiums, on application to the home office at the third or any subsequent anniversary of the insurance, within the accumulation period, under the terms of the company's loan agreement then in use and the following conditions:

First. That premiums have been duly paid in full to the time when the loan is made, including the premium for the entire insurance year then beginning.

Second. That the amount loaned at any time shall be such as the insured may desire and not to exceed the sums shown in the table on the preceding page. The amount of any loan shall include any previous loan then unpaid.

Third. That this insurance bond shall be duly assigned to the company as collateral security for the loan and deposited at the home office. A duplicate of the loan agreement, which is also a receipt for the bond, will be furnished to the insured.

Fourth. That interest in advance at the rate of five per cent per annum shall be paid on all loans from the date of the loan to the next anniversary of the insurance, and annually in advance thereafter, if the loans are renewed until they are paid off.

Fifth. That the loans shall be made for the period ending upon the next succeeding anniversary of the insurance, and may then be renewed simply by payment of the insurance premiums falling due and interest in advance, as above. Thus the loan may be renewed from year to year, at the option of the insured, until the completion of the accumulation period.

2. NONFORFEITURE

This insurance bond can not be forfeited after it shall have been in force three full years, as hereinafter provided:

First. If any subsequent premium is not duly paid, this
26 insurance will be endorsed for the amount of paid-up insurance specified in the table on the preceding page, less the value of any indebtedness on this bond, provided demand is made therefor with surrender of this bond within six months after such nonpayment—such paid-up insurance being payable either if the insured shall die before the nineteenth day of May, nineteen hundred and nineteen, or if the insured shall then be living; or, subject to the same conditions, this bond may be endorsed for the same amount of paid-up insurance, but payable at death only, with a guaranteed annual income, beginning on the date specified in the first "accumulation benefit" on the preceding page equal to four per cent of the total amount of premiums paid, taken at the tabular annual rate; or,

Second. If any subsequent premuim is not duly paid, and if this insurance bond is not surrendered as provided in the preceding clause, the insurance under this bond will, after the repayment of any indebtedness, be extended without request or demand therefor for the amount of fifty thousand dollars during the term provided in the table on the preceding page, payable only if the insured dies within said term. At the end of said term the insurance shall cease and the amount provided in the last column in said table will become payable if the insured is then living.

Third. The insurance provided for in the two preceding clauses shall be based upon completed insurance years only, and shall be subject to the conditions of this insurance bond, but without further payment of premiums and without loans, participation in surplus, or premium return.

3. GRACE IN PAYMENT OF PREMIUMS

A grace of one month will be allowed in payment of premiums after this insurance bond shall have been in force three months, subject to an interest charge at the rate of five per cent per annum for the number of days during which the premium remains due and unpaid. During the month of grace this insurance bond remains in force, and the unpaid premium, with interest as above, remains an indebtedness to the company, which will be deducted from the amount payable under this bond if the death of the insured shall occur during the month.

27 4. REINSTATEMENT IN EVENT OF LAPSE

This insurance bond will be reinstated on written application therefor within six months after nonpayment of any premium, subject

to evidence of good health satisfactory to the company, and payment of premiums to date of reinstatement with interest at the rate of five per cent per annum.

5. CHANGE OF BENEFICIARY

The insured may at any time during the continuance of this insurance bond, provided the bond is not then assigned, change the beneficiary or beneficiaries by written notice to the company at the home office, accompanied by this bond, such change to take effect on the endorsement of the same on the bond by the company.

6. GENERAL REGULATIONS

No agent has power in behalf of the company to make or modify this or any contract of insurance, to extend the time for paying any premium, to waive any forfeiture, or to bind the company by making any promise, or making or receiving any representation or information. These powers can be exercised only by the president, vice president, second vice president, actuary, or secretary of the company, and will not be delegated.

All premiums are due and payable at the home office, unless otherwise agreed in writing, but may be paid to agent producing receipt signed by the president, vice president, second vice president, actuary, or secretary and countersigned by such agents. If any premium is not paid on or before the day when due, this insurance bond shall become void, and all payments previously made shall remain the property of the company except as hereinbefore provided.

Proofs of death must be furnished to the company at the home office within one year after the death of the insured, which proofs shall comprise satisfactory statements establishing the claim. Such statements must comply fully with the company's forms in use at the time of the death of the insured. If it is found that the age of the insured was incorrectly stated in the application on which this insurance bond was issued, the amount payable under this bond shall be such proportion of the amount of the bond as the premium paid bears to the required premium at the true age.

Any indebtedness to the company, including any balance of
28 the current year's premium remaining unpaid, will be deducted in any settlement of this insurance bond or of any benefit thereunder.

Any assignment of this insurance bond must be made in duplicate and both sent to the home office, one duplicate to be retained by the company and the other to be returned. The company has no responsibility for the validity of any assignment.

SPECIAL ADVANTAGES—TABLE OF AMOUNTS PAYABLE IN EVENT OF DEATH DURING THE ACCUMULATION PERIOD IF PREMIUMS ARE PAID IN FULL TO DATE OF DEATH

The amount payable to the insured in event of death prior to May 19th, 1919, as specified on the face of the bond, will be set forth in the following table:

Year	Amount payable	Year	Amount payable
First to tenth inclusive	$50,000	Sixteenth	$861,050
Eleventh	$50,700	Seventeenth	$904,150
Twelfth	$52,700	Eighteenth	$895,700
Thirteenth	$54,800	Nineteenth	$909,350
Fourteenth	$57,000	Twentieth	$872,150
Fifteenth	$59,300		

TABLE OF LOANS AND OF SURRENDER VALUES

In paid-up insurance or extended insurance, under the conditions specified on the next page.

29

At end of—	Loans	Paid-up insurance	Surrender values (extended insurance for $50,000 for the term specified below, with cash, if then living)
2nd year	7,000	$15,000	17 Years 0 months with $4,100 cash
3rd "	10,000	20,000	16 " 0 " " 11,700 "
4th "	13,000	25,000	15 " 0 " " 19,300 "
5th "	16,700	30,000	14 " 0 " " 26,250 "
6th "	20,100	35,000	13 " 0 " " 31,600 "
7th "	24,150	40,000	12 " 0 " " 36,300 "
8th "	28,600	45,000	11 " 0 " " 41,800 "
9th "	33,000		
10th "	37,700		
11th "	42,900		
12th "	47,900		
13th "	53,700		
14th "	59,200		
15th "	65,200		
16th "	71,600		
17th "	78,300		
18th "	85,400		
19th "	92,800		
20th "	For special advantages at end of accumulation period, see accumulation benefits below.		

ACCUMULATION GUARANTEES

This insurance bond participates in surplus as hereinafter provided, but no dividend shall be apportioned to it before the end of the accumulation period. If the insured elects to continue this insurance bond beyond the accumulation period, under one of the two accumulation benefits first named below, no further dividend shall be apportioned to it before the end of each period of five years thereafter.

The accumulation period of this insurance bond ends on the nineteenth day of May in the year nineteen hundred and nineteen. If the insured is living, and if the premiums have been duly paid to that date and not otherwise,

The company will then apportion a dividend to the insured, who shall have the option of continuing, or discontinuing, this insurance bond under one of the following:

30 FOUR ACCUMULATION BENEFITS

(1) Receive an income of two thousand dollars and no cents per annum during life (being equal to four per cent on the initial amount of the insurance ($50,000), the payment to be made on the nineteenth day of May, nineteen hundred and twenty, and receive the dividend converted into a life annuity, payable with the income as above, and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

(2) Receive the dividend in cash, and receive an income for life, payable as specified in the "first benefit," and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

(3) Receive the entire cash value, as stated below, converted into an annual income during the life of the insured, payable as provided in the "first benefit," which income the company guarantees shall be not less than thirty-four hundred and seventy-four dollars and no cents, and discontinue this insurance bond; or,

(4) Receive the entire cash value, as stated below, in cash, and discontinue this insurance bond.

The company guarantees that the entire cash value of this insurance bond at the end of the accumulation period shall be fifty thousand dollars, and in addition the cash dividend then apportioned by the company.

At the end of the accumulation period the company will send the insured a written statement, setting forth the results under each of the above accumulation benefits, and if the insured shall fail at that time to notify the company which benefit has been selected, the first benefit will be considered selected.

State of Kentucky.
County of Jefferson, ss:

I, Mildred M. Spaulding, a notary public in and for the State and county aforesaid, do hereby certify that the foregoing is a full, true, and complete copy of insurance policy issued by the New York Life Insurance Company on the life of Alexander A. J. Alexander, No. 950778, dated the fifth day of June, 1899, as appears from a photostatic copy of the original of said policy in my possession.

31 In testimony whereof I have hereunto set my hand and affixed the seal of my office at the city of Louisville, Kentucky, this 24th day of December, 1924.

[SEAL.]

MILDRED M. SPALDING,
Notary Public.

My commission expires June 21, 1925.

In United States District Court

Order re depositions

April 11, 1925

On a hearing in open court, and good cause being shown, and by agreement of counsel, it is ordered that depositions be taken in conformity with the stipulation filed in this action.

In United States District Court

Answer

Filed October 30, 1925

Now comes defendant herein, Robert H. Lucas, collector of internal revenue for the district of Kentucky, and by leave of court first obtained files this his answer to plaintiff's amended petition herein, and answering Paragraph I thereof, denies that plaintiff's income-tax return for the calendar year 1919, filed before March 15, 1920, showed net income from farming in the sum of $22,469.09 or a greater sum than $22,269.09, or that said income-tax return showed a net income of $65,880.21 or a greater net income than the sum of $65,608.21; denies that there was added to the policies of insurance issued to plaintiff by the New York Life Insurance Company on May 19, 1899, annual accumulations from that date to the maturity date of said policies, May 19, 1919; denies that said policies were worth on March 1, 1913, the sum of $115,511.00, or any amount in excess of the sum of $78,100.00, the value of said policies as of March 1, 1913, found and determined by the Commissioner of Internal Revenue; and said defendant denies that said Commissioner of Internal Revenue was in error in valuing said policies as of March 1, 1913, at the sum of $78,100.00.

32

Answering Paragraph II of said plaintiff's amended petition, defendant denies that said sum of $5,200.00 paid to said plaintiff by Security Trust Company, of Lexington, Kentucky, and included by plaintiff in his taxable income for the year 1919 was a gift, and further denies that said sum was not a part of plaintiff's taxable income for said calendar year 1919.

Defendant denies that reasonable and fair depreciation for the calendar year 1919 on plaintiff's interest in said Ashland Block Association amounted to the sum of $3,333.33, or any sum greater than $1,666.66, and further denies that plaintiff's net income from rents for the calendar year 1919 was the sum of $25,319.01, or any sum less than $26,985.67.

Defendant denies that plaintiff's computation of his gross income and deductions for the calendar year 1919 set forth in said Paragraph II of said amended petition is true and correct; denies that

said plaintiff is entitled to deductions for repairs, wear, and tear in the sum of $4,084.61, or in any sum exceeding the sum of $2,417.95; denies that plaintiff's income from rents for the calendar year 1919 was the sum of $25,319.01, or any sum less than the sum of $26,985.67; denies that said plaintiff received as income in the calendar year 1919 on the surrender of his said policies of life insurance to said New York Life Insurance Company less than the sum of $42,697.00, and denies that said plaintiff received thereon as dividends on insurance policies only the sum of $5,286.00, or any sum less than $20,797.00; denies that said plaintiff received as net income from all sources for the calendar year 1919 less than the sum of $102,513.21, or a taxable net income of less than $86,630.54.

33 Defendant further denies that plaintiff's tax liability for the calendar year 1919 was the sum of $7,997.11, or any sum less than $22,149.70.

Defendant denies that said plaintiff ever paid to this defendant any additional taxes for the year 1919 under duress and/or protest; denies that said plaintiff paid to this defendant income taxes for the year 1919 in the sum of $11,334.17, or any sum in excess of the sum of $8,750.91, and said defendant denies that said sum of $8,750.91, or any part thereof was paid to him by plaintiff under protest, and/or under threats and duress by said defendant.

Defendant denies that said additional income taxes in the sum of $11,334.17 for the calendar year 1919 complained of in said amended petition and certified to this defendant for collection by the Commissioner of Internal Revenue were erroneously assessed against said plaintiff.

Defendant denies that he is indebted to said plaintiff in said sum of $11,334.17, with interest thereon from October 26, 1923, or in any sum whatever.

Wherefore, having answered, the defendant prays that the petition as amended be dismissed, and he prays for his costs herein expended, and for all general and proper relief.

ROBERT H. LUCAS,
Collector of Internal Revenue for the Second District of Kentucky.
By W. S. BALL,
United States Attorney,
Attorney for Defendant.

[*Duly sworn to by Robert H. Lucas; jurat omitted in printing.*]

34 In United States District Court

Amended petition

Filed April 14, 1926

Comes the plaintiff, A. J. A. Alexander, and by leave of court amends his petition and for amendment states:

That on or before March 15, 1920, he filed with the collector of internal revenue at Louisville, Kentucky, his income-tax return for

the year 1919, and on February 28, 1920, he paid to the collector of internal revenue for the district of Kentucky three thousand two hundred and eighty-three dollars and eighty-eight ($3,283.88) cents, and a like amount on June 14, September 15, and December 14, 1920, the total of which was the amount of tax shown to be due on his original return.

Plaintiff says that on October ———, 1923, the Commissioner of Internal Revenue assessed additional taxes against him for the year 1919 in the sum of eleven thousand three hundred and thirty-four dollars and seventeen ($11,334.17) cents and certified same to the defendant, Robert H. Lucas, collector of internal revenue for the district of Kentucky for collection, and that said Lucas immediately demanded payment thereof, and in his demand threatened to assess penalties and interest on the tax thus assessed unless paid.

Plaintiff says that on November 2, 1923, in order to avoid the imposition of penalties and a seizure of his property, by the defendant, he paid to the defendant under protest the sum of eight thousand and thirteen dollars and fifty-four ($8,013.54) cents, and on December 5, 1923, under the same circumstances and for the same reasons, he paid to the defendant, Robert H. Lucas, collector of internal revenue for the district of Kentucky, seven hundred and thirty-seven dollars and thirty-seven ($737.37) cents.

Plaintiff says that after the above payments were made, there was outstanding against him on the assessment list in the office of collector of internal revenue for the district of Kentucky two thousand five hundred and eighty-three dollars and twenty-six ($2,583.26) cents, and on December 5, 1923, he filed with the defendant, Robert H. Lucas, collector of internal revenue for the district of Kentucky, a claim for credit against the balance so outstanding for income taxes overpaid in the year 1918 in the sum of one thousand and seventy-two dollars and forty-one ($1,072.41) cents; 1920, four hundred and thirty-four dollars and ninety-seven ($434.97) cents; 1921, four hundred and twenty-four dollars and twenty-one (424.21) cents; 1922, six hundred and fifty-one dollars and sixty-seven
35 ($651.67) cents, a total for all years of two thousand five hundred and eighty-three dollars and twenty-six ($2,583.26) cents.

Plaintiff says that the defendant, Robert H. Lucas, collector of internal revenue for the district of Kentucky, forwarded said claim for credit to the Commissioner of Internal Revenue, Washington, D. C., and that said commissioner has ever since said time had said claim under consideration, but has neither approved or rejected it.

Plaintiff says that on the 2 day of November, 1923, he filed with the collector of internal revenue for the district of Kentucky a claim for refund in the sum of twelve thousand four hundred and forty one dollars and sixty ($12,441.60) cents, said claim including eight thousand seven hundred and fifty dollars and ninety one ($8,750.91) cents, which was paid to the defendant, Robert H. Lucas, collector of internal revenue under protest as hereinbefore stated.

Plaintiff says that said claim was forwarded by the defendant to the Commissioner of Internal Revenue, Washington, D. C., and that the said commissioner has had said claim under consideration from the ——— day of December, 1923, to the present time and has neither approved or rejected it.

Plaintiff says that no part of the eight thousand seven hundred and fifty dollars and ninety one ($8,750.91) cents paid by him to the defendant, Robert H. Lucas, collector of internal revenue for the district of Kentucky, was due or owing by him to the United States for income taxes for the year 1919, and all of said sum is now due and owing to him with six per cent interest thereon from December 5, 1923, until paid.

Wherefore plaintiff prays, as in his original petition, for his cost and all proper relief.

ELWOOD HAMILTON,
Attorney for Plaintiff.

36 In United States District Court

Amended answer

Filed April 16, 1926

Now comes defendant herein, by W. Sherman Ball, United States attorny for the western district of Kentucky, his attorney, and for answer to plaintiff's amended petition filed April 14, 1926, denies that said plaintiff on the 5th day of December, 1923, or at any time, filed with the collector of internal revenue for the district of Kentucky claim for refund in the sum of $12,441.60 or for any other sum; denies that said claim was forwarded by the defendant to the Commissioner of Internal Revenue, Washington, D. C., or that said commissioner has had said claim under consideration or that he has neither approved nor rejected it.

Defendant denies that no part of the sum of $8,750.91 paid by plaintiff to defendant was due or owing by plaintiff to the United States for income taxes for the year 1918, and further denies that said sum of $8,750.91 or any other sum whatever is now due or owing to said plaintiff.

Wherefore, having answered, defendant prays that plaintiff's amended petition herein be dismissed, and further prays for its costs herein expended and for all general and proper relief.

THE UNITED STATES OF AMERICA,
By W. S. BALL,
United States Attorney,
Attorney for Defendant.

[*Duly sworn to by W. S. Ball; jurat omitted in printing.*]

37 In United States District Court

General demurrer

Filed April 16, 1926

Now comes the defendant herein and demurs to plaintiff's amended petition filed herein on the grounds that said amended petition does not state facts sufficient to constitute a cause of action against this defendant.

W. S. Ball,
United States Attorney,
Attorney for Defendant.
E. H. Horton,
Special Attorney, Bureau of Internal Revenue,
Of Counsel.

In United States District Court

Opinion

This is a suit to recover income taxes for the year 1919, exacted for the plaintiff under the deficiency assessment, and paid by him under protest. A jury was waived, separate findings of facts and conclusions of law requested, and the case submitted on an agreed statement of facts and certain depositions. The record, as finally made up, presents the single question of what taxable gain, if any, was realized by the plaintiff in 1919, upon the cashing in by him of two insurance policies issued to him as of May 19, 1899.

These policies were issued by the New York Life Insurance Company and were each for the sum of $50,000.00. They were what are known as participating deferred dividend policies, and by their terms were to be fully paid up upon the payment of ten annual premiums each for the sum of $3,905.00, with a twenty-year accumulation period. The premiums on the two policies total $78,100.00, and the payments thereon were completed on March 19, 1908. The twenty-year accumulation period ended on the 19th day of May, 1919. The plaintiff was twenty-four years old at the time these policies
28 were issued. In the event of the death of the insured the policies were payable to his estate. They were exactly alike, and they provided that if the plaintiff should be living at the end of the accumulation period, he might exercise either of four enumerated options. The policies in this respect provide as follows:

"This insurance bond participates in surplus as hereinafter provided, but no dividend shall be apportioned to it before the end of the accumulation period. If the insured elects to continue this insurance bond beyond the accumulation period, under one of the two accumulation benefits first named below, no further dividend shall be apportioned to it before the end of each period of five years thereafter.

"The accumulation period of this insurance bond ends on the nineteenth day of May in the year nineteen hundred and nineteen. If the insured is living, and if the premiums have been duly paid to that date and not otherwise.

"The company will then apportion a dividend to the insured, who shall have the option of continuing or discontinuing this insurance under one of the following four accumulation benefits:

"(1) Receive an income of two thousand dollars and no cents per annum during life (being equal to four per cent on the initial amount of the insurance ($50,000), the first payment to be made on the nineteenth day of May, nineteen hundred and twenty, and receive the dividend converted into a life annuity, payable with the income as above, and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

"(2) Receive the dividend in cash and receive an income for life payable as specified in the 'first benefit' and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

"(3) Receive the entire cash value, as stated below, converted into an annual income during the life of the insured, payable as provided in the 'first benefit,' which income the company guarantees shall be not less than thirty-four hundred and seventy-four dollars and no cents, and discontinue this insurance bond; or,

39 "(4) Receive the entire cash value as stated below, in cash, and discontinue this insurance bond.

"The company guarantees that the entire cash value of this insurance bond at the end of the accumulation period shall be fifty thousand dollars, and in addition the cash dividend then apportioned by the company.

"At the end of the accumulation period the company will send the insurance a written statement, setting forth the results under each of the above accumulation benefits, and if the insured shall fail at that time to notify the company which benefit has been selected, the first benefit shall be considered selected."

Each policy also provided that if the insured died at any time before the end of the tenth year after its issue the beneficiary would be paid the sum of $50,000.00 in full satisfaction thereof. Each policy also contained a schedule of the amounts payable in event of death at any time between the end of the tenth year and prior to May 19, 1919, as follows:

11th year	$50,700
12th "	52,700
13th "	54,800
14th "	57,000
15th "	59,300
16th "	61,650
17th "	64,150
18th "	66,700
19th "	69,350
20th "	72,150

Each policy also contained provisions with reference to paid-up and extended insurance, as well as a schedule of loan values. The loan-value schedule begins at the end of the third year, and is as follows:

3rd	year	$7,900
4th	"	10,000
5th	"	13,500
6th	"	16,750
7th	"	20,350
8th	"	24,350
9th	"	28,000
10th	"	30,000
11th	year	32,700
12th	"	34,900
13th	"	37,300
14th	year	39,700
15th	"	42,250
16th	"	44,950
17th	"	46,500
18th	"	48,100
19th	"	49,900

The policies contained no cash surrender value schedule, but it is admitted that the loan value schedule had the same effect as a cash surrender value, because the insured could borrow the scheduled loan value, and if he did not desire to repay it he could surrender the policy and would owe the insurance company nothing.

Subsequent to May 19, 1919, the end of the accumulation period, plaintiff elected to exercise the fourth option heretofore set out, and upon such election the insurance company paid to him on each of the policies $50,000.00 as the face thereof and $10,398.50 as accumulations, or a total on the two policies of $120,797.00.

The Commissioner of Internal Revenue found that under section 213 of the revenue act of 1918 (act of February 24, 1919) and under article 72 (b) of regulation 45 (1920 edition) of the Treasury Department the taxable gain realized by the plaintiff should be determined by deducting from the sum of $120,797.00 the sum of $78,100.00, representing the return, without interest, of the premiums actually paid by the plaintiff on these policies. The plaintiff contends that the only taxable gain realized by him on the transaction was the difference between the sum of $120,797.00, the amount received by him upon surrender of his policies in 1919, and the fair value of these policies as of March 1, 1913.

The pertinent part of section 213 of the revenue act of 1918 declares that the term gross income—

"(b) * * * does not include the following items, which shall be exempt from taxation under this title. * * *

"2. The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract, or upon surrender of the contract."

Article 72 (b) of regulation 45 (1920 edition) provides:

41 "During his life only so much of the amount received by an insured under life, endowment, or annuity contracts as

represents a return without interest of premiums paid by him therefor is excluded from his gross income."

Whatever value these policies had on March 1, 1913, must be taken into consideration in determining what taxable gain was realized by the plaintiff upon their surrender in 1919. Their value on March 1, 1913, constituted invested capital, no part of which could be converted into income for taxation purposes in 1919, either by act of Congress or by department regulation. If, as a matter of fact, these policies on March 1, 1913, had an actual value in excess of the premiums which had been paid, this value, rather than the premiums paid, must be deducted from the sum received in 1919 in order to determine taxable gain.

The defendant advances the suggestion that if the actual value of the policies as of March 1, 1913, is to be employed as the basis for determining the taxable gain realized upon surrender of the policies in 1919, then the only value which can be assigned to them as of March 1, 1913, would be their loan value or cash surrender value as of that date, shown by the schedule set out in the policies to be $37,300.00 each, or a total of $74,600.00. This contention is based upon the provision of the policies, unless he lived out the twenty-year accumulation period, which had not expired on March 1, 1913; that under the terms of the policies the insurance company was not required to, and as a matter of fact had not, prior to the end of the accumulation period, irrevocably set aside to these policies any part of the accumulations which would ultimately go to them if the insured lived out the accumulation period; that therefore, inasmuch as the plaintiff could not sell his policies and had no right to them, the only demonstrable provisionally allotted to them, the only demonstrable value these policies had on March 1, 1913, was the scheduled loan value or surrender value thereof, which on that date was $37,300.00 each, or a total of $74,600.00.

It is true that the insurance company had not finally set aside to these policies any part of the accumulations which would ultimately belong to them if the plaintiff lived out the accumulation period, nor did the plaintiff on that date have any present title to such accumulations. The record shows, however, that the company had year by year provisionally ascertained the amount
42 of accumulations attributable to each of these policies, and the amount thus provisionally ascertained and set aside on March 1, 1913, was $6,800.00, or $13,600.00 for the two policies. The record also shows that it was known that the rate of accumulation during the last few years of the accumulation period would be greater than the earlier years prior to 1913.

Of course, under the terms of the policies, if the plaintiff had elected to surrender his policies in 1913 and claim his rights thereunder, he would have gotten no part of the accumulations, but I can not accede to the contention that this fact fixed the value of the plaintiff's two contracts as of that date, either at their loan value

or at the amount of the premiums which had been paid. The premiums had already been paid. There was no possibility of the policies lapsing for nonpayment of premiums. At the time they were issued the record shows that the plaintiff was a young man twenty-four years of age. In 1913 he was thirty-eight years of age. The record fails to show that he had other than the average expectancy of life. According to the mortality table in common use in Kentucky his expectation of life on March 1, 1913, was 26.91 years. In determining the value of his policies on March 1, 1913, it would not have been unreasonable for the plaintiff to have anticipated that he would live out the accumulation period, which had only six years two months and eighteen days to run, and would thereby receive the special property rights in the contracts inuring to him at the end of the accumulation period. He could have ascertained that there had already been assigned to those two policies, provisionally, $13,600.00. He could have ascertained that the rate of accumulation for the remainder of the accumulation period would have been equal to, if not in excess of, what it had been in the past. If it had maintained the same ratio, however, for the last six years of the accumulation period which it had maintained for the first fourteen, he could reasonably have anticipated that the $13,600.00 provisionally set aside to the policies in 1913 would have grown to $19,428.57 at the end of the accumulation period on May 19, 1919.

An examination of the schedule of loan values demonstrates that on May 19, 1913, he could have collected as a loan or cash surrender value on each of these policies $39,700.00, or a total of $79,400.00. Of course the plaintiff knew this on March 1, 1913. On that date he knew that if he lived until the end of the year beginning May 19, 1914, he could have collected as cash surrender
43 value on each of these policies $42,250.00, or a total of $84,500.00, and that if he were living at the end of each subsequent policy year, his rights under the loan schedule were rapidly increasing in value. He also would collect $57,000.00 on each of these policies, with a rapidly mounting scale of death values, should death occur in subsequent years and prior to May 19, 1919.

In view of these manifest benefits conferred by the policies, how can it be rationally contended that the only value of these insurance contracts on March 1, 1913, was the sum of the premiums paid, without interest, or the loan values assigned to them on that date? To reach any such conclusion would be to disregard the facts. It is, of course, true that on March 1, 1913, it was not certainly known that the plaintiff would live out the accumulation period. Yet this same character of uncertainty is encountered by the courts constantly in determining the value of life estates in property, particularly in the allotment of dower. It is true that there is no method by which the value of these policies can be ascertained with mathematical exactness as of March 1, 1913, but the plaintiff should not be made to bear the entire burden of this condition when their value as of that date can be

fairly approximated, and when it is clear that by the application of any fair standard of value they were worth in excess of the sum claimed by the Government.

Under all the circumstances, I think it is fair to both the Government and the plaintiff to fix the value of what the plaintiff could at that date have reasonably anticipated they would have been worth on the 19th day of May, 1919, under the fourth option heretofore referred to, arriving at the then present value by the application of a four per cent interest rate, compounded annually. As I have heretofore indicated, I think the plaintiff on March 1, 1913, could reasonably have anticipated that at the end of the accumulation period he would receive at least $19,428.57 of accumulations, and in addition thereto the face value of the policies, or a total of $119,428.57. The present value of this sum on March 1, 1913, at four per cent interest, compounded annually, would be $93,587.81. This amount, I think, should be treated as the fair value of the plaintiff's two policy contracts on March 1, 1913. Deducting this sum from $120,797.00, the amount actually received by the plaintiff upon surrender of his policies at the end of the accumulation period would result in a taxable gain of $27,209.19. Of this sum $20,797.00 was paid out of earned surplus, and is, therefore, taxable as dividends, which $6,412.19 thereof would be subject to both normal and surtax.

Counsel for plaintiff will prepare a judgment conforming to the views herein expressed, with a finding of facts as herein indicated and as more fully stipulated in the record, and present same for entry.

CHAS. I. DAWSON, *Judge.*

MARCH 9, 1927.

ELWOOD HAMILTON,
BECKHAM, HAMILTON & BECKHAM,
Attorneys for plaintiff.
W. SHERMAN BALL, *U. S. District Attorney.*
A. E. GEBBS, *Gen'l Counsel Bureau of Internal Revenue,*
EDWARD H. HORTON, *Atty. Bureau of Internal Revenue,*
Attorneys for Defendant.

In United States District Court

Judgment and findings of fact

March 9, 1927

This cause coming on to be heard and the law and facts being submitted to the court, a jury being expressly waived by the parties, the court finds, adjudges, and decrees that the plaintiff recover of the defendant, Robert H. Lucas, collector of internal revenue for the district of Kentucky, six thousand five hundred nineteen dollars and thirty-six (86,519.36) cents, with six per cent interest thereon from

December 2, 1923, until the date of the entry of this judgment, and his costs in this action expended, for all of which he may have execution.

It is further adjudged and decreed by the court that there was reasonable cause for the collection of the above sum from the plaintiff by the defendant and that he shall not be personally responsible therefor.

45 In determining the above judgment the court finds the following facts to be true:

First. Plaintiff is a citizen of Kentucky and resides at Spring Station, in the eastern district of Kentucky.

Second. Defendant is a resident of Louisville, Kentucky, and since the 24th day of May, 1921, has been the duly appointed, acting, and qualified collector of internal revenue for the district of Kentucky.

Third. Plaintiff, before March 15, 1920, duly filed with the then collector of internal revenue for the district of Kentucky his income-tax return for the calendar year 1919 and showed thereon, among things as income, dividends on insurance policies in the sum of $17,290.35 and a total net income of $65,690.21, and thereafter duly paid voluntarily and without protest to the then collector of internal revenue taxes assessed thereon in the sum of $13,135.52.

Fourth. Plaintiff on the 5th day of June, 1899, upon his application, was granted by the New York Life Insurance Company of New York City, New York, effective May 19, 1899, two policies of life insurance, each in the sum of $50,000.00 and each on the face thereof described as "insurance bond with guaranteed interest." Plaintiff agreed to pay on each policy in advance premiums at the rate of $3,905.00 per annum for a period of ten years, and his premium payments on said policies in the total sum of $78,100.00 were completed on March 19th, 1908.

Said New York Life Insurance Company is a mutual life insurance company doing business on the mutual-level premium plan.

Fifth. Each of said policies contained the following provisions as to deferred dividends and surplus:

"ACCUMULATION GUARANTEED

"This insurance bond participates in surplus as hereinafter provided, but no dividend shall be apportioned to it before the end of the accumulation period. If the insured elects to continue this insurance bond beyond the accumulation period under one of the two accumulation benefits first named below, no further dividend shall be apportioned to it before the end of each period of five years thereafter.

"The accumulation period of this insurance bond ends on the nineteenth day of May in the year nineteen hundred and nineteen.

If the insured is living and if the premiums have been duly paid
46 to that date, and not otherwise, the company will then apportion a dividend to the insured, who shall have the option of

continuing or discontinuing this insurance bond under one of the following four accumulation benefits:

"(1) Receive an income of two thousand dollars and ——— cents per annum during life (being equal to four per cent on the initial amount of the insurance, $50,000), the first payment to be made on the nineteenth day of May, nineteen hundred and twenty, and receive the dividend converted into a life annuity, payable with the income as above, and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

"(2) Receive the dividend, in cash, and receive an income for life, payable as specified in the 'first benefit,' and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

"(3) Receive the entire cash value, as stated below, converted into an annual income during the life of the insured, payable as provided in the 'first benefit,' which income the company guarantees shall be not less than thirty-four hundred and seventy-four dollars and ——— cents, and discontinue this insurance bond; or,

"(4) Receive the entire cash value, as stated below, in cash, and discontinue this insurance bond.

"The company guarantees that the entire cash value of this insurance bond at the end of the accumulation period shall be fifty thousand dollars, and in addition the cash dividend then apportioned by the company.

"At the end of the accumulation period the company will send the insured a written statement, setting forth the results under each of the above accumulation benefits, and if the insured shall fail at that time to notify the company which benefit has been selected, the first benefit shall be considered selected."

Sixth. Each of said policies matured on the 19th days of May, 1919, and plaintiff elected to receive from the company, in
47 accordance with the provisions of said option #4, the cash surrender value thereof, to wit, $120,797.00, and subsequently said company on the surrender to it of said policies of insurance paid to said plaintiff in the calendar year 1919 cash to the amount of said $120,797.00.

Seventh. On reaudit of plaintiff's income-tax return for said calendar year 1919 the Commissioner of Internal Revenue determined and found the amount of income realized by plaintiff on the surrender of his said policies to be the sum of $42,697.00, or the difference between the cash surrender value thereof, $120,797.00, and the total premiums paid by plaintiff, $78,100.00, and after making certain adjustments not material here duly assessed an additional tax for said calendar year 1919 of $11,334.17 against said plaintiff.

Eighth. Plaintiff, prior to bringing this action against defendant on May 27th, had not paid the amount of said additional taxes assessed against him by said Commissioner of Internal Revenue, but had paid to said defendant only a portion thereof, to wit, the sum of $8,750.91, as follows:

On November 2nd, 1923, plaintiff paid to defendant the sum of $8,013.54 under written protest and later, on December 5th, 1923, the further sum of $737.37, making a total payment by said plaintiff to said defendant of said sum of $8,750.91, and no more, on said additional assessment of $11,334.17.

Ninth. Plaintiff, on December 5th, 1923, filed with defendant certain claims for credit for alleged overpayment of income taxes for the calendar years 1918, 1920, 1921, and 1922 in the sums of $1,072.41, $434.97, $424.21, and $651.67, respectively, claiming total credits on account thereof in the sum of $2,583.26 as against said additional assessment of $11,334.17 for said calendar year 1919, and that said credit claims were duly transmitted to the collector of internal revenue, but no action thereon has been as yet taken by said Commissioner of Internal Revenue.

Tenth. Subsequent to the assessment of said additional tax of $11,334.17 against said plaintiff by said Commissioner of Internal Revenue, said plaintiff filed with this defendant a purported claim in abatement and claim for refund in the sums of $3,320.63 and $4,894.39, respectively, to which was attached an amended return executed by said plaintiff for said calendar year 1919, which showed, among other things, "income from insurance policy" of
48 $21,900.00, a total net taxable income of $70,621.39, and a total tax, according to plaintiff's computation, of $16,132.20.

Eleventh. Said purported claim for abatement and claim for refund was not transmitted by the defendant to the Commissioner of Internal Revenue at Wa... ...ton, D. C., but said defendant notified said plaintiff by letter dated October 31st, 1923, as follows:

OCTOBER 31, 1923.

JJB/ES
IT-2
Mr. A. J. A. ALEXANDER,
Care Beckham, Hamilton & Beckham,
Inter-Southern Building, Louisville, Kentucky.

SIR: This office is in receipt of your letter of the 26th instant enclosing check for $8,013.54 to apply on assessment of additional income tax for the year 1919; also a claim in abatement for $3,320.63 covering the remainder of the assessment.

I regret to advise that this additional assessment is made by the Commissioner of Internal Revenue in accordance with section 250 (d) of the revenue act of 1921, which prohibits the collection from accepting a claim in abatement. It is therefore necessary to ask that payment of the full amount of $11,334.17 be made, and after the full payment is received the claim will be allowed to operate as a refund claim. Under the law there is no other course for this office to pursue, and I trust that you will forward remittance for $3,320.63 by return mail.

Respectfully,

ROBT. H. LUCAS, *Collector.*
By Chief, Income Tax Division.

Twelfth. After plaintiff filed said credit claims for said years 1918, 1920, 1921, and 1922, referred to in paragraph ninth hereof, plaintiff, on March 13th, 1924, filed with this defendant's claim for refund in the sum of $18,755.87, which defendant duly transmitted to the Commissioner of Internal Revenue at Washington, D. C., but said Commissioner of Internal Revenue had taken no action thereon on or prior to May 27th, 1924.

Thirteenth. Said plaintiff, in filing his original return for said calendar year 1919, had failed to claim a deduction for depre-
49 ciation on certain real estate in which he had an interest in the city of Chicago; and said Commissioner of Internal Revenue, on consideration of plaintiff's claim for refund of March 13th, 1924, allowed a portion of the depreciation, and on October ——, 1925, on account thereof, duly issued to said plaintiff a certificate of overassessment for said calendar year 1919 in the sum of $2,319.99.

Fourteenth: That the correct income of the plaintiff for the year 1919 is as follows:

Gross income:			
Income from farming			$61,216.48
Deductions:			
Labor		$7,195.42	
Material supplies		12,154.87	
Merchandise bought for resale		32,972.40	
General expense		2,075.75	
Inventory beginning of year		36,980.00	
		91,378.44	
Less inventory at end of year		59,365.00	
		32,013.44	
Other deductions:			
Salaries		3,612.78	
Rent		24.00	
Interest		780.67	
Taxes		1,830.00	
Repairs		656.50	
			38,917.39
			22,299.09
Other income:			
Salaries			2,000.00
Income from rent		45,842.51	
Deductions:			
Repairs, wear and tear	$2,417.86		
Interest	4,583.33		
Taxes	4,543.15		
Other expenses	7,312.41		
		18,856.84	
Income from rents			26,985.67
Trust income			5,200.00
Income from insurance policies			6,412.19
Dividends on insurance policies			20,797.60
Interest on bonds, foreign country			163.79
Ordinary dividends			4,337.11
			88,184.85

Other deductions:		
Interest	1,005.00	
Taxes paid	237.67	
Contributions	13,029.32	
		14,331.99
		73,832.86

Fifteenth: That the income tax to be determined on the above income is as follows:

Net income:		
Deductions	73,832.86	
Dividends	25,134.11	
Exemption	1,400.00	
	26,534.11	
	47,298.75	
Taxable at 4%	4,000.00	160.00
Taxable at 8%	43,289.75	3,463.18
Surtax		11,743.17
Total tax		15,367.07

Sixteenth: That the plaintiff paid to the collector of internal revenue on income shown on his original return, taxes in the following amounts:

Feb. 28, 1920	3,283.88	
June 14, 1920	3,283.88	
Sept. 15, 1920	3,283.88	
Dec. 4, 1920	3,283.88	
		$13,135.52

Seventeenth: That the plaintiff paid to the Collector of Internal Revenue on an additional assessment of taxes for 1919 in the amount of $11,334.17 the following amounts:

Nov. 2, 1923	8,013.54	
Dec. 5, 1923	737.37	
		$8,750.91

Eighteenth: That the defendant, Robert H. Lucas, collector
51 of internal revenue for the district of Kentucky, erroneously collected on Nov. 2, 1923, but with probable cause, $6,519.36, from the plaintiff, income taxes for the calendar year 1919.

Nineteenth: That the court finds the March 1, 1913, value of the two insurance policies to be $93,587.81, which sum deducted from the amount received by the plaintiff on the surrender of the policy, to wit, $127,797.00, leaves a taxable gain of $27,209.19. Of this sum, $20,797.00 was paid out of earned surplus, and therefore taxable as dividends, and the balance of $6,412.19 subject to both normal and surtax.

Twentieth: The defendant objects and excepts to the judgment herein and so much of the findings of fact as determine the value of the insurance policies March 1, 1913, to be $93,587.81.

In United States District Court

Order extending time for filing bill of exceptions

Entered March 9, 1927

On application of the defendant, it is ordered that he be, and is hereby, given until the 2nd day of May, 1927, within which to prepare and present for settlement and approval his bill of exceptions in this case, including the evidence in narrative form.

In United States District Court

Order filing bill of exceptions

April 30, 1927

This day the defendant, by counsel, tendered in open court his bill of exceptions herein, including the evidence in narrative form, with the approval of counsel for the plaintiff endorsed thereon, and the court having examined same, it is approved, ordered filed, and made a part of the record for the purpose of appeal.

In United States District Court

Bill of exceptions

Filed April 30, 1927

Be it remembered that on the trial of this cause in this court at the regular October term (1926), judgment rendered March 9th, 1927, of said court, the honorable Charlie I. Dawson, judge, presiding, when the following proceedings were had, to wit, a jury was waived by stipulation, which is in words and figures, as follows:

Waiver of jury trial and stipulation of facts

Filed April 16, 1926

Now comes plaintiff and defendant and thereupon it is stipulated and agreed that trial by jury be waived in the above-entitled action and that the issues of fact and of law may be heard, tried, and determined by the court, and it is requested that the court make special findings of fact and its conclusions of law thereon separately stated.

(And thereupon, the plaintiff, to sustain the issue upon his part, offered testimony as follows: A stipulation of facts agreed upon by attorneys for both plaintiff and defendant, which is in words and figures as follows:)

It is further stipulated and agreed that the following facts are true and may be found as facts in the case.

First: Plaintiff is a citizen of Kentucky and resides at Spring Station in the eastern district of Kentucky.

Second: Defendant is a resident of Louisville, Kentucky, and since the 24th day of May, 1921, has been the duly appointed, acting, and qualified collector of internal revenue for the district of Kentucky.

Third: Plaintiff, before March 15th, 1920, duly filed with the then collector of internal revenue for the district of Kentucky his income tax return for the calendar year 1919 and showed thereon, among things as income, dividends on insurance policies in the sum of $17,290.35 and a total net income of $65,690.21, and thereafter duly paid voluntarily and without protest to the then collector of internal revenue taxes assessed thereon in the sum of $13,135.52.

Fourth: Plaintiff on the 5th day of June, 1899, upon his application was granted by the New York Life Insurance Company, of New York City, New York, effective May 19, 1899, two policies of life insurance, each in the sum of $50,000.00 and each on the face thereof described as "insurance bond with guaranteed interest." Plaintiff agreed to pay on each policy in advance premiums at the rate of $3,905.00 per annum for a period of ten years and his premium payments on said policies in the total sum of $78,100.00 were completed on March 19th, 1908.

Said New York Life Insurance Company is a mutual life insurance company doing business on the mutual level premium plan.

Fifth: Each of said policies contained the following provisions as to deferred dividends and surplus:

"ACCUMULATION GUARANTEES

"This insurance bond participates in surplus as hereinafter provided, but no dividend shall be apportioned to it before the end of the accumulation period. If the insured elects to continue this insurance bond beyond the accumulation period, under one of
54 the two accumulation benefits first named below, no further dividend shall be apportioned to it before the end of each period of five years thereafter.

"The accumulation period of this insurance bond ends on the nineteenth day of May in the year nineteen hundred and nineteen. If the insured is living, and if the premiums have been duly paid to that date, and not otherwise, the company will then apportion a dividend to the insured, who shall have the option of continuing or discontinuing this insurance bond under one of the following four accumulation benefits:

"(1) Receive an income of two thousand dollars and ——— cents per annum, during life (being equal to four per cent on the initial amount of the insurance ($85,000), the first payment to be made on the nineteenth day of May, nineteen hundred and twenty, and receiv

the dividend converted into a life annuity, payable with the income as above, and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

"(2) Receive the dividend in cash and receive an income for life, payable as specified in the 'first benefit,' and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

"(3) Receive the entire cash value, as stated below, converted into an annual income during the life of the insured, payable as provided in the 'first benefit,' which income the company guarantees shall be not less than thirty-four hundred and seventy-four dollars and ——— cents, and discontinue this insurance bond; or,

"(4) Receive the entire cash value, as stated below in cash, and discontinue this insurance bond.

"The company guarantees that the entire cash value of this insurance bond at the end of the accumulation period shall be fifty thousand dollars, and in addition the cash dividend then apportioned by the company.

"At the end of the accumulation period the company will send the insured a written statement, setting forth the results under each of the above accumulation benefits, and if the insured shall fail at that time to notify the company which benefit has been selected, the first benefit shall be considered selected."

Sixth: Each of said policies matured on the 19th day of May, 1919, and plaintiff elected to receive from the company, in accordance with the provisions of said option #4, the cash surrender value thereof, to wit, $120,797.00, and subsequently said company on the surrender to it of said policies of insurance paid to said plantiff in the calendar year 1919 cash to the amount of said $120,797.00.

Seventh: On reaudit of plaintiff's income-tax return for said calendar year 1919, the Commissioner of Internal Revenue determined and found the amount of income realized by plaintiff on the surrender of his said policies to be the sum of $42,697.00, or the difference between the cash surrender value thereof, $120,797.00, and the total premiums paid by plaintiff, $78,100.00, and after making certain adjustments not material here, duly assessed an additional tax for said calendar year 1919 of $11,334.17 against said plaintiff.

Eighth: Plaintiff, prior to bringing this action against defendant on May 27th, 1924, had not paid the amount of said additional taxes assessed against him by said Commissioner of Internal Revenue, but had paid to said defendant only a portion thereof, to wit, the sum of $8,750.91, as follows:

On November 2nd, 1923, plaintiff paid to defendant the sum of $8,013.54 under written protest, and later, on December 5th, 1923, the further sum of $737.37, making a total payment by said plaintiff to said defendant of said sum of $8,750.91, and no more, on said additional assessment of $11,334.17.

Ninth: Plaintiff on December 5th, 1923, filed with defendant certain claims for credit for alleged overpayments of income taxes for the calendar years 1918, 1920, 1921, and 1922, in the sums of $1,072.41, $434.97, $424.21, and $651.67, respectively, claiming total credits on account thereof in the sum of $2,583.26 as against said additional assessment of $11,334.17 for said calendar year 1919, and that said credit claims were duly transmitted to the collector of internal revenue, but no action thereon has been as yet taken thereon by said Commissioner of Internal Revenue.

Tenth: Subsequent to the assessment of said additional tax of $11,334.17 against said plaintiff by said Commissioner of In-
56 ternal Revenue, said plaintiff filed with this defendant a purported claim in abatement and claim for refund in the sums of $3,320.63 and $4,894.39, respectively, to which was attached an amended return executed by said plaintiff for said calendar year 1919 which showed, among other things, "Income from insurance policy" of $21,900.00, a total net taxable income of $70,621.39, and a total tax according to plaintiff's computation of $16,132.20.

Eleventh: Said purported claim for abatement and claim for refund was not transmitted by the defendant to the Commissioner of Internal Revenue at Washington, D. C., but said defendant notified said plaintiff by letter dated October 31st, 1923, as follows:

OCTOBER 31, 1923.

JJB/ES
IT-2
Mr. A. J. A. ALEXANDER,
Care of Beckham, Hamilton & Beckham,
Inter-Southern Building, Louisville, Kentucky.

SIR: This office is in receipt of your letter of the 26th instant, enclosing check for $8,013.54 to apply on assessment of additional income tax for the year 1919; also a claim in abatement for $3,320.63 covering the remainder of the assessment.

I regret to advise that this additional assessment is made by the Commissioner of Internal Revenue in accordance with section 240 (d) of the revenue act of 1921, which prohibits the collector from accepting a claim in abatement. It is, therefore, necessary to ask that payment of the full amount, $11,334.17, be made, and after the full payment is received the claim will be allowed to operate as a refund for this office to pursue, and I trust that you will forward remittance for $3,320.63 by return mail.

Respectfully,

ROBT. H. LUCAS, *Collector.*
By CHIEF, *Income Tax Division.*

Twelfth: After plaintiff filed said credit claims for said years 1918, 1920, 1921, and 1922 referred to in paragraph nine hereof, plaintiff on March 13th, 1924, filed with this defendant an alleged claim for refund in the sum of $18,733.87, which defendant duly trans-

mitted to the Commissioner of Internal Revenue at Washing-
37 ton, D. C., but said Commissioner of Internal Revenue had taken no action thereon, on or prior to March 27th, 1924.

Thirteenth. Said plaintiff in filing his original return for said calendar year 1919 had failed to claim a deduction for depreciation on certain real estate in which he had an interest in the city of Chicago and said Commissioner of Internal Revenue on consideration thereof determined and found that plaintiff was entitled to claim as a deduction a portion of said depreciation, and, accordingly, duly issued an account thereof on October —, 1925, a certificate of overassessment for said calendar year 1919 in the sum of $2,319.99.

Fourteenth. It is agreed that certain depositions now on file in this case may be considered by the court in connection with facts heretofore stipulated to be true.

Fifteenth. Said plaintiff has now pending in the District Court of the United States for the Eastern District of Kentucky and action brought by him against the United States in which he is seeking to recover the sum of $5,138.41, the same being a portion of the taxes assessed against him for said calendar year 1919 by the Commissioner of Internal Revenue, which case involves the same question as that presented to the case at bar, to wit, the correctiness of said commissioner's assessment on the proceeds of plaintiff's said insurance policies.

(Signed) ELWOOD HAMILTON,
BECKHAM, HAMILTON & BECKHAM,
Attorneys for Plaintiff.

(Signed) W. S. BALL,
United States Attorney,
Attorney for Defendant.

(Signed) E. H. HORTON,
Special Attorney,
Bureau of Internal Revenue,
Of Counsel.

The plaintiff further offered as evidence upon his part the testimony of witnesses taken by depositions as agreed upon by stipulation, which is as follows:

38 *Stipulation re testimony*

Filed Apr. 11, 1925

In this cause it is hereby stipulated between the plaintiff and the defendant that either of the parties may take the deposition of witnesses they may desire to take by agreement as to time and place, or on reasonable notice to the other party; that said deposition shall be taken before any officer authorized to take depositions in the State where the witness testifies.

The testimony of such witnesses may be taken down stenographically after having been sworn and then transcribed on the typewriter, signature of witnesses being waived.

(Signed) BECKHAM, HAMILTON & BECKHAM,
Attorneys for Plaintiff.

(Signed) W. S. BALL,
Attorney for Defendant.

Certain exhibits are filed with and made a part of the stipulation of facts, which exhibits cannot be conveniently copied into this bill of exceptions, and on that account said exhibits are permitted to be withdrawn and filed herewith and made a part hereof. There are also certain exhibits filed with and made a part of the depositions, which exhibits cannot conveniently be copied, and are permitted to be withdrawn and filed herewith as a part hereof.

The stipulation of facts hereinbefore copied herein, together with the exhibits, embrace all of the evidence introduced on behalf of the defendant and to sustain the issue upon his part. This was all of the evidence in the case.

The depositions of the following witnesses, Samuel L. Wilson and Walter Gregory Bowerman, were taken, which are in words and figures as follows:

Deposition of SAMUEL L. WILSON taken by Greenwood Reporter at 1111 New York Life Building, New York, New York, to be read as evidence on behalf of the plaintiff on the trial in the above-styled cause.

The witness, being first duly sworn, deposes as follows:

(Interrogated on behalf of plaintiff by Attorney Hamilton.)

59 1st Q. Mr. Wilson, please state your name, age, residence, and occupation.

A. Samuel L. Wilson; age, fifty-eight; residence, 1154 Eighty-third Street, Brooklyn, New York. I am chief clerk of the general division, actuarial department, New York Life Insurance Company.

2nd Q. Are you an actuary, Mr. Wilson?

A. I am not.

3rd Q. Is anybody with the department who is an actuary that we can take today?

A. If necessary, yes.

4th Q. As chief clerk, Mr. Wilson, have you the custody of the policy records of the New York Life Insurance Company?

A. Some of them.

5th Q. Have you custody of the records relating to policies numbered 930,777 and 930,778; amount, $50,000 each; issued to A. J. A. Alexander on the 5th day of June, 1899?

A. They are accessible to me.

6th Q. When were those policies actually issued by the New York Insurance Company, Mr. Wilson?

A. May 19th, 1899.

7th Q. What premium did the policies carry?

A. Thirty-nine hundred and five dollars annually for ten years in each case.

8th Q. Were they participating policies?

A. They were.

9th Q. Would you please tell us what is meant by the term "participating policies"?

A. These policies provided that a dividend would be apportioned to them at the end of the 20-year accumulation period. These were deferred-dividend policies. This period terminated on May 19, 1919. That dividend was to be apportioned provided the insured was living and the policies were in full force on May 19, 1919.

10th Q. How was the dividend to be determined?

A. From the experience of the company within the twenty years.

11th Q. What do you mean by the experience of the company?

A. With respect to these groups. Mr. Bowerman can testify to that more than I can as to the making up of the dividend.

12th Q. Do you have the possession of the records of the New York Life Insurance Company so that you can tell what surplus was apportioned to each of these policies?

40 A. Yes. The accumulated dividend was $10,398.50 in each case.

13th Q. Do you mean on each policy?

A. Yes; on each policy.

14th Q. You say the accumulated dividends on each policy. What do you mean by accumulated dividends?

A. It is the dividend that accumulates to the policy during the 20-year deferred dividend period.

15th Q. How do you determine the accumulations?

A. Well, I said Mr. Bowerman can tell you how the dividends are calculated better than I can.

16th Q. Have you any records in your possession showing the dividends set aside on that policy annually from the date it was issued?

A. I haven't them with me. By the way, I might say this, that there is no dividend set aside on this particular policy each year. The dividend would be set aside for the group.

17th Q. Mr. Wilson, did the New York Life Insurance Company have dividend formulas at the time these policies were issued?

A. They did.

18th Q. Have you a copy of those formulas?

A. I can get copies of the—well, now, you say the formulas in use in 1899. Before I answer that question may I ask you——

Mr. HAMILTON. What I want are the formulas in use at the time dividends were apportioned to these policies.

Mr. WILSON. I can get those for you.

Mr. HAMILTON. Would you please get a copy and file it with our deposition and mark it "Wilson, No. 1"?

Mr. WILSON. These formulas of which you speak are set forth in the reports of this company to the insurance commissioner of the State of New York for the various years.

Cross-examination by Mr. Horton:

1st Q. From your records, Mr. Wilson, was there a beneficiary named in this policy?

A. No, sir. It was payable to his estate.

2nd Q. Administrators, executors, or assigns?

A. Yes. I do not know the exact wording of the policy.

SAMUEL S. WILSON.

61 Subscribed and sworn to before me this 20th day of April, 1925.

[SEAL.] MABEL E. CURRAN,

Notary Public, Kings County No. 313, Register No. 6348. Certificate filed in New York Co. No. 692, Register No. 6138A.

My commission expires March 30, 1926.

Deposition of Mr. WALTER GREGORY BOWERMAN, taken at the same time and place, to be read as evidence on behalf of the plaintiff on the trial in the above-styled cause.

(Interrogated on behalf of plaintiff by Attorney HAMILTON.)

1st Q. Please state our name, age, residence, and occupation.

A. Walter Gregory Bowerman; age, thirty-one; residence, 19 Glenwood Avenue, Leonia, New Jersey; occupation, actuary.

2nd Q. Are you connected with the New York Life Insurance Company?

A. I am.

3rd Q. What connection have you with it?

A. I am an assistant in the actuarial department.

4th Q. What experience have you had in valuing insurance policies?

A. I have had about ten years' experience in three or four companies and then actuary and examiner of the insurance department of West Virginia.

5th Q. What professional training did you have to fit yourself as an actuary?

A. I have passed the examination as a fellow of the Actuarial Society of America and as an associate of the American Institute of Actuaries.

6th Q. How long have you been connected with the New York Life Insurance Company?

A. Since November 16th, 1919.

7th Q. What insurance companies have you been connected with since you started in your line of work?

A. The Equity Life, of New York; the George Washington Life, of Charleston, West Virginia; and the New York Life.

62 8th Q. Have you access to the records of the New York Life Insurance Company as they relate to the two life insurance policies issued on the life of A. J. A. Alexander in 1899?

A. I have.

9th Q. Please give me the date and amount of those two policies.

A. The date of issue of each policy was the 19th of May, 1899, and the face amount of each policy $50,000.

10th Q. To what particular class of policies do these policies belong?

A. These policies are what are called 4% bond policies, payable by ten annual premiums maturing at the end of twenty years, with an accumulated dividend payable at that time.

11th Q. What do you mean by 4% policies?

A. A 4% bond policy has a provision in it showing the method in which the settlement may be made at maturity.

12th Q. What relation has 4% to that?

A. Simply that in one of the options that funds may be left with the company and a guarantee be made of not less than 4% each year.

13th Q. Does that 4% commence before or after the maturity of the policy?

A. After the maturity.

14th Q. Were these policies called group policies?

A. There is also a provision in the policy providing that the amount payable in the event of the death of the insured subsequent to the end of ten yars from issue and before the end of twenty years shall be definite amounts ranging from $50,000 to $72,150 00 per policy.

15 Q. You say that provision related to the insured dying within the 20-year period and subsequent to the 10-year period?

A. Yes.

16th Q. What particular part of the policy do you refer to, Mr. Bowerman?

A. On the top of the second page of the policy under the heading "Special advantages" a table is given showing "Table of amounts payable in event of death during the accumulation period if premiums are paid in full to date of death."

17th Q. What amount would have been paid on this policy if Mr. Alexander had died March 1st, 1913?

A. The amount as set forth in the table referred to in event of death with the fourteenth policy year is $57,000 on each policy.

18th Q. Did the New York Life Insurance Company have in 1899 regular dividend formulas?

A. I don't believe I could say what formulas they had in 1899.

19th Q. Have you access to the records of the company as you could ascertain whether or not it did have any dividend formulas at the time this policy was issued, and do they have now?

A. I haven't seen any formulas that were in use in 1899 for the calculation of dividends. We do now have formulas for that purpose.

20th Q. Did the New York Life Insurance Company have dividend formulas at the time these two policies were issued, Mr. Bowerman?

Mr. HORTON. That is hardly a fair question to ask Mr. Bowerman.

A. I do not know.

21st Q. Were these policies group policies?

A. I do not believe I understand what you mean by group policies.

22nd Q. Did these policies of Dr. Alexander participate in all of the surplus of the company?

A. Each policy provided for participation in surplus on the 19th day of May, 1919, if the insured were then living and all premiums were duly paid.

23rd Q. Was that participation in the surplus that was attributable to a group of policies or to all the policies of the company in force on that day?

A. Did it apply to a group or to all the policies of the company?

24th Q. Yes. I mean the surplus that this policy was to participate in, was it to be the surplus attributable to all the policies or to a particular group of policies? In other words, did every policy that you had in existence at that time participate in the surplus, or did these policies participate only in surplus that was attributable to a group or class of policies?

A. The policy states "This insurance bond participates in surplus as hereinafter provided."

25th Q. Well, now, what surplus does that relate to?

A. The policy does not state the answer to that question. The practice of the company in 1919 was to make up what is called a dividend history. These histories are made up for broad groups of policies, showing the experience of the company with respect to mortality, withdrawal, surrender values paid, interest earned, and other factors. The result of these histories shows, in a broad
64 way, the funds earned by typical groups of policies, and from these histories the actual surplus to be distributed is calculated very simply.

26th Q. How did the New York Life Insurance Company determine what sum would be paid to Mr. Alexander when these two policies matured?

A. Such a dividend history as I have just referred to was made up, and the values obtained at quinquennial ages were interpolated to give the values at the actual age at issue of these policies. The details of this method are set forth under similar policies in the annual report of December 31st, 1919, to the superintendent of insurance of New York State.

27th Q. Please file with your deposition a copy of the history that was made up at the time you determined what sum was payable to Dr. Alexander on account of these two policies.

A. I think we can file a sheet that will show the principles which underly that method and an example for a typical policy where the main principles are the same.

28th Q. What is the reason that you can not give these as to these two particular policies?

A. This printed form that we have for presenting to the insurance department is made up to show the main principles involved in typical ages for the large group of policies.

29th Q. When you speak of a large group of policies, what do you mean by that; that is rather an indefinite term?

A. Well, we have a history made up for such a group as is called the nonforfeiting group.

30th Q. Well, do these apply to that group?

A. These are in much smaller group that I question whether the report to the insurance department has an example of the calculation of the accumulation group to which these policies belong.

31st Q. When did you first know the exact sum that the company owed Dr. Alexander?

A. The amount payable, of course, is payable in event that the insured is living at the maturity of the policy. The calculations showing the amount which would be payable if the insured were then living were probably made about a year previous to the maturity.

32nd Q. Well, in fact, when were they made?

A. They were probably made about a year previous to the maturity of the policy.

33rd Q. Is there anything in the files of the company showing just how you determined the value of these policies at the maturity date?

A. No doubt the principles governing the calculations are in the files of the company, but, obviously, there is a good deal of clerical work which is not put out in writing; it is simply done at the time and the results are distributed and the details are not retained.

34th Q. It isn't a guess, is it?

A. Certainly not. The method of board averages has to be followed, of course, regarding ages and small groups of policies. For instance, the interest earned is that earned on all the investments of the company; profits and losses from investments are distributed over a number of years.

35th Q. How many years? What I would like you to do if you can, without me making you questions, is to tell us the exact method that you used or would have used in determining how much was paid to Dr. Alexander at the maturity of these policies.

Mr. Horton. The method the company used as he knows it.

Mr. Hamilton. Yes.

A. There is a paper which was published in 1905 written by the now vice president of the New York Life, Rufus W. Weeks, which explains in about thirty or forty pages the principles to which you refer. This paper is referred to in the annual statement made to the superintendent of insurance.

36th Q. Were the accumulations on these policies fixed with mathematical accuracy at the time they matured?

A. As I understand the question, my answer is "Yes."

37th Q. Now give me the method that you used in determining with mathematical accuracy the sum to be paid.

A. The description of the method involve two or three hours and it is all in black and white by the vice president of the company, and the digest of it, which is published every year, is available for the year 1919.

38th Q. I am afraid I would not understand it, and I am afraid the court would not understand it. Will you state briefly just how you determined the amount that was paid?

A. The principle involved in distributing accumulation div.-
66 dends at maturity of such policies as the two policies referred to is the principle of averages. There are certain factors——

39th Q. Well, now, would you give us those factors which are taken for the entire company?

A. You mean for all the policies of the company?

40th Q. Yes; for all the policies of the company.

A. There are other factors which are particularly all located and calculated for small groups of policies——

41st Q. This was a small group?

A. For example: In the calculation of the accumulation dividends under these policies the interest rates used was the interest rate earned on the investments of the entire company, while the withdrawal rate was a rate determined from the deferred dividend policies of the company issued in a group of years, and that rate was then further modified with respect to the age of the insured and the size of the premium paid under each policy.

42nd Q. What was the amount paid at the date of maturity of these policies?

A. The amount of the accumulation dividend paid under each policy at maturity was $10,398.60. The face amount of each policy was $50,000, making a total sum paid at maturity of $60,398.50.

43rd. Q. When was the surplus earned by the company that each of these policies participated in?

Mr. Bowerman. When was the surplus earned?

Yes.

A. It is provided in each policy that no dividends shall be apportioned to the policy prior to the 19th day of May, 1919. However, the company maintained funds each year representing the amount which had accrued under its deferred dividend policies which were issued in the previous years.

44th Q. When did dividends first begin to accrue on these policies?

A. For a period of several years after the issue of these policies there was probably no surplus available because of the heavy initial expenses incident to the issue of life insurance policies.

45th Q. What was the annual premium on each of these policies?

A. The annual premium on each policy payable for ten years was $3,905.00.

46th Q. What was the cost of writing these two particular policies?

67 A. The cost of writing the policies involves a commission to the agent, the expenses at the home office of making up the records, and the examination of the insured and the numerous other items of overhead expense incident to the issue of new life-insurance policies. It is very difficult to assign numerical values to these costs for any individual policy alone.

47th Q. Well, what was the cost of writing this particular group?

A. We do not have numerical figures for that.

48th Q. You said these policies were assigned to a smaller group in answer to a question a moment ago. What group were they assigned to?

A. I stated at the beginning of my testimony the description of the policies both as regards premiums and the insurance benefits, including the dividend class to which they belonged.

49th Q. Well, I know; but to what class did they belong? How did you determine the class they were to go in?

A. The dividend class is called the 20-year accumulation class.

50th Q. How many policies did the New York Insurance Company have in effect when these policies were issued belonging to that class?

A. I do not know.

51st Q. Is there any way you can ascertain that?

A. I think it would be rather difficult to find the figures of that year, but it is——

52nd Q. Were they classified as to ages, Mr. Bowerman?

A. Well, the calculations of accumulation dividends are, of course, made up first for the dividend class and then distributed according to age.

53rd Q. What reserve did the company begin to accumulate from the date of the policy to pay the policies at maturity? In other words, you knew, or, rather, the company knew, at the time it issued these policies that it had to pay certain definite sums if the insured lived until the year of 1919. Now, what reserves did you build up to pay the policies at maturity?

A. There were two reserves set aside for that purpose; one was the policy reserve liability and the other was the amount provisionally ascertained and held waiting apportionment at maturity of the policies, representing the surplus accrued at the end of each year, to be later allocated to the individual policies making up the group of deferred dividends of the company.

68 54th Q. What reserves had been accumulated to pay these particular policies December 31st, 1912, Mr. Bowerman?

A. I could answer that question for March 1st, 1913, because I have the figures here.

Mr. HAMILTON. All right.

Our records show that the share of each of the above policies in the aggregate sum provisionally ascertained and held awaiting apportionment was on March 1st, 1913, $6,800. The total value of each policy on March 1st, 1913, including the sum provisionally ascertained and held awaiting apportionment was $44,100.

55th Q. What would be the total of those two sums?

A. That is the total sum on each policy.

56th Q. Including the full force to pay the contingent liability, you say it was $44,000.

A. The total value of each policy, including the sum provisionally ascertained and held awaiting apportionment is $44,100.

Mr. Horton. What was the sum at this date other than the unapportioned dividend at that date?

That sum on each policy was $37,300.

And what did that represent?

That represented the sum shown in the policy under the table "Table of loans and surrender values" in the column called "Loans."

57th Q. These policies did not have any surrender value, did they?

A. The policies provided for loans and for paid-up insurance and extended insurance for a definite number of years and months. The last two columns are termed in the policies "Surrender values."

58th Q. But they did not have any surrender values ordinarily used, did they?

A. There is no amount in the policies designated "Cash-surrender value."

59th Q. Well, then, the policies did not have a provision for cash-surrender value that is ordinarily used at the present time in insurance policies.

A. It is true that the column in the policy is called "Loans" and it is not called "Cash-surrender value."

60th Q. What were the surplus accumulations on these policies December 31st, 1914?

69 A. I do not have figures showing the share in the unapportioned surplus funds of the company at December 31st, 1914.

61st Q. Well, didn't the accumulations on these policies occur regularly over the life of the policies?

A. The surplus funds increase more and more rapidly for each year of duration of the policy so that there is more surplus added to the unapportioned funds in the latter part of the accumulation period than in the first part. However, under these policies, since they were payable by ten annual premiums, the proportion earned in the first ten years was to that extent increased.

62nd Q. Well, these policies did not earn any more, relatively, from March 1st, 1913, up to the date of maturity than they did before, did they?

A. The answer to this question can be seen by comparing the $6,800 share on March 1st, 1913, with the $10,398.50 actually paid on May 19th, 1919, which was practically six years later.

63rd Q. Well, that is comparing with the group where the premium was paid annually up to maturity, isn't it?

A. No.

64th Q. What is it that caused it to earn more during the years subsequent to March 1st, 1913?

A. The difference between $6,800 and the amount paid as dividend at maturity is $3,598.50.

65th Q. What is the reason for that?

A. During the period from March 1st, 1913, to the maturity of these policies there were gains from mortality, from interest, and from miscellaneous minor sources of income.

66th Q. Do you mean it was more in those years than in other years?

A. No.

67th Q. What was the present value of those policies March 1st, 1913—on each of them?

A. I do not have a calculation showing the reserve value set aside by the company at that date. The loan value that I quoted above is the only value I have corresponding to that.

68th Q. Well, is that the same as the present value March 1, 1913?

A. No.

69th Q. Assuming that Dr. Alexander retained his policies to maturity and he was paid according to the provisions of the policy, what was the present worth of those policies March 1st, 1913?

70 A. I do not have figures here showing anything other than the figures that I quoted for that date.

70th Q. Could you ascertain those for me?

A. I could find out what the reserve was that was held by the company at the end of 1912 or 1913.

Will you do that and complete the answer to the question, unless there is some objection to it?

(See figures on sheet 21–a.)

71st Q. What was the total reserve of the company for liability and dividends on the group policies to which these policies belonged March 1st, 1913?

A. I do not have our figures available in that form.

72nd Q. Well, in what form have you them?

A. We have rates per thousand for each type of policy that we have on our books and then we have them for other groups which are quite different from the dividend groups.

20 PAY. 20-YEAR 4% BOND ISSUED 1899, AGE 24. $50,000. A. P. $3,905

VALUES PER EACH POLICY

End of pol. year	Insurance reserve liability		Funds provisionally ascertained and held awaiting apportionment	End of pol. year	Insurance reserve liability		Funds provisionally ascertained and held awaiting apportionment
	Basis of policy guarantees	Basis held by company			Basis of policy guarantees	Basis held by company	
	(1)	(2)	(3)		(1)	(2)	(3)
1	$2,650	$2,650	0	11	$36,500	$44,800	$3,200.00
2	5,400	5,400	0	12	37,800	46,050	5,550.00
3	8,300	8,800	450	13	39,200	47,400	6,250.00
4	11,300	12,200	1,100	14	40,650	48,750	6,750.00
5	14,400	15,800	1,750	15	42,050	50,100	7,350.00
6	18,150	19,150	2,400	16	43,550	51,500	7,950.00
7	22,000	23,000	3,000	17	45,100	52,950	8,450.00
8	26,050	26,800	3,750	18	46,700	54,400	9,000.00
9	30,300	30,900	4,500	19	48,300	55,900	9,700.00
10	33,200	38,750	4,850	20	50,000	57,450	10,300.00

71 The basis of the values in the first column above is the actuaries or combined experience table of mortality and 4% interest, which is also the legal minimum basis of valuation for the policies in question.

The reserve held by the company, as shown in column two above, is on the following basis:

Years	Basis
1 to 9	Actuaries, 4%.
10	American experience, 3½%.
11 to 20	American experience, 3%.

In all cases the loan value available is less than the insurance reserve liability on the basis of policy guarantees.

73rd Q. Well, could you give it to me as reserve for liability on the policies March 1st, 1913?

A. I can give you the reserve liability at the end of each of the calendar years 1912 and 1913 on these policies as they were held at that time by the company, and I have given you the value as of March 1st, 1913, of the share in the funds provisionally ascertained and held awaiting apportionment.

74th Q. Yes; you have given me that; but you have not given the reserve for the liability.

A. No; that is what I can obtain.

Mr. HAMILTON. Well, will you do that and complete your answer? (See figures on sheet 21–a.)

75th Q. Would you please furnish the reserve for liability on these policies from the date of issue annually during their life and also the reserve for dividends annually from the beginning of the policy to its maturity date, and if you are unable to furnish these two reserves allocated to the group to which the policies belong?

Mr. HORTON. An objection to the last part of the question on the ground that it is immaterial to this case because it does not show the segregation of these two policies.

A. The policy reserve is not difficult to get, because there are tables all made up for that, but the other is rather a long calculation.

76th Q. I believe you stated that these were 4% policies?

72 A. That is part of the title of the policy as it is described in our calculations, and there is a guarantee in the policy that——

77th Q. What you mean by 4% is to invest the premium so that the premium invested will yield that net annually?

A. One of the provisions under the accumulation benefits provided at the maturity of the policy is that the person at interest may receive an income of $——— per annum during life, being equal to 4% of the total amount of premiums taken at the tabular annual rate, and receive the dividend converted into a life annuity and

continue this insurance bond without further payment of premiums. That is where the title "4%" enters into the contract.

78th Q. Mr. Bowerman, you say that these particular policies—that the accumulations were more subsequent to March 1st, 1913, than prior to March 1st, 1913?

A. The accumulation in the dividend fund?

79th Q. Yes; the dividend fund and the reserve.

A. No. We stated the figures in the dividend fund, which changes from $6,800 to $10,398.50. That increase of $3,598.50, of course, is less than the $6,800 under each policy; thus there was $3,500 approximately, that accumulated after March 1st, 1913.

80th Q. How did the liability reserve accumulate on these particular policies; is that the same each year?

A. Although I do not have a calculation showing these policies, an index of it is obtained from the increase in the loan value of the policies, which changes from $37,300 at the end of the thirteenth year to $50,000 at the end of the twentieth year.

81st Q. The loan value, however, is less than the liability reserve?

A. The company does not loan more than the liability reserve; it is either less or equal to the liability reserve.

82nd Q. Well, in this particular case, was the liability reserve less or equal or more than the loan value?

A. I do not have those figures. Those are the figures I am going to supply.

Cross-examination by Mr. HORTON:

1st Q. Mr. Bowerman, do your records show that any loans were made on these policies?

A. Yes; they do.

2nd Q. Will you state what those are and when?

73 A. Our records show the following entries regarding loans on these policies:

POLICY 950,777

Date of loan or reduction of increase:	Loan
June 1st, 1910	$32,700
May 9th, 1911	34,900
May 9th, 1913	25,000
March 9th, 1914	5,000
May 19th, 1914	0

POLICY 950,778

Date of loan or reduction of increase:	Loan
November 19th, 1913	$39,700
December 30th, 1914	35,000
October 18th, 1916	32,000
January 31st, 1917	30,000
November 23rd, 1918	20,000
May 13th, 1919	0

3rd Q. How was the loan value on this last policy, the loan made November 19th, 1913, $39,700, computed?

A. The amount is the amount shown in the policy as the guaranteed loan at the end of the fourteenth year, which would be at May 19th, 1913.

4th Q. Now, what relation did that loan have to the reserve fund?

A. The reserve fund would either be equal to or greater than the loan value.

5th Q. That is, this loan was not equal to the reserve fund on that date?

A. It would not be greater than the policy reserve liability.

6th Q. The policy reserve liability?

A. That is the reserve liability excluding any share in undivided, provisionally ascertained surplus.

7th Q. That was also true of the loans on the other policy, the same statement?

A. Yes.

8th Q. And that is always true, according to your experience and the practice of the company?

A. The insurance laws provide that any excess of loan over policy reserve liability shall be deducted as an asset not admitted and reliable and well-established companies do not loan more than the reserve liability attributable to the individual policy.

74 9th Q. Then this loan was not based, as I understand you, upon any consideration of this deferred dividend reserve?

A. There is no share of the deferred dividend in such a loan.

10th Q. And there never is any share in the deferred dividend reserve, in the case of a loan, under such policies as these?

A. Not in this company.

11th Q. Now, you understand the controversy here in the case is the March 1st, 1913, value of these policies. Could the surrender value of these policies have been demanded on March 1st, 1913, and, if not, was it a policy of the company to pay surrender values on such policies in 1913 if they had been demanded?

A. The loan value was available and the insured had the right to surrender his policy after obtaining that loan, without repayment.

12th Q. What was the maximum loan value on these policies on their surrender March 1st, 1913?

A. On each policy, $37,300.

13th Q. On March 1st, 1913, that would be a total on both policies of $74,600?

A. Yes.

14th Q. On the other hand, what was the total of premiums that had been paid on the policies on that date?

A. $39,050 each.

15th Q. That is a total of $78,100?

A. Yes.

16th Q. Why was it that the surrender value of these policies, had such surrender value been asked March 1st, 1913, was not equal to the amounts of the premiums which had been paid, $78,100?

A. That is due, briefly, to two reasons, one being that the policy, although a 20-year bond policy, is paid up entirely at the end of ten years by ten annual premium payments; and, secondly, that the cash value of the policies is, as with all life insurance contracts, the amount which remains after the death losses have been paid for the period elapsed from issue of the policy.

17th Q. Can you state whether or not this policy was in the nature of a 10-year payment, 20-year endowment, with a 20-year deferred dividend; was that the nature of the policy?

A. That is the nature of the policy, with the exception that the policy is called an insurance bond with guaranteed interest, which is not quite so simple as the term "endowment" as it is usually employed.

75 18th Q. The matter to which you have just referred is one of the four options granted by the policy, is it not?

A. There are several features, as I testified earlier in the day, which distinguish the 4% bond policies, such as these contracts; one is the increased death benefit beyond the face during the period from the end of the tenth to the end of the twentieth years, which is during the accumulation period; and the other is in the special options allowed at the maturity of the policies.

19th Q. What happened in this case was the surrender of the policies and a cash payment at the end of the accumulation period?

A. Yes.

20th Q. What interest did Dr. Alexander have in these accumulations prior to May, 1919; that is to say, were they payable to him in event of his death or to anyone? Would any portion of the dividends set aside for the class in which Dr. Alexander's policies belonged have been paid to him in the event of surrender in 1913?

21st Q. Where were these policies of insurance issued, Mr. Bowerman, if you know?

A. The question of jurisdiction of the insurance policy is a legal question that I am not competent to answer, since it varies with different jurisdictions. The policy states that the New York Life Insurance Company agrees to pay the face amount at the home office of the company in the city of New York upon receipt of and approval of proofs of death, etc.

22nd Q. Do you know where the policy, as a fact, was actually issued?

A. That is the legal question which I am not competent to answer.

23rd Q. I am asking for a fact, if you know.

A. That to my mind depends upon the meaning of the word "issue." Do you mean whether it was actually signed here in the home office?

24th Q. Is there any knowledge you have of that?

A. The policy was actually written and sent out from the home office.

25th Q. Mr. Bowerman, will you define what you mean by "tabular annual rate" used in the policy, the expression you used—whether it means the gross premium or net premium?

A. The tabular annual rate of premium paid refers to the gross premium paid by the insured.

26th Q. And not to the net premium?

A. Not to the net premium.

76 27th Q. Mr. Hamilton asked you about how the costs of these policies were determined. Can the actual costs of these policies be predetermined or is the cost determined subsequent to their issue upon the company's experience?

A. Under participating policies the gross premium which is charged is determined in advance with a sufficient margin to allow for contingencies and normal distribution of surplus which remains after the contingencies which have occurred have been provided for.

28th Q. You mean there is a net premium calculated and then a loading to take care of these contingencies you speak of?

A. Yes; and also to provide for a normal surplus distribution.

29th Q. I wish you would define what you mean by the term "deferred dividend."

A. A dividend is a refund of premium and a deferred dividend is a dividend which, it is provided in the insurance contract, is not apportionable until the end of a deferred period. It is payable, as stated in the contract, only in event of the insured being still alive and premium payments having been duly made.

30th Q. Then, if I understand you, this deferred dividend is the excess over the cost of the insurance which is accumulated during the term of the premiums paid.

A. The cash value of the policy is the excess which remains from the net premiums paid over the insurance cost of the policy accumulated with interest and benefit of survivorship, and the dividends are, similarly, the excess of the gross premiums paid accumulated with interest and benefit of survivorship over the cash value of the policy and the mortality and other charges which occur each year.

31st Q. Can you state again what the cash value of these insurance policies were on March 1st, 1913?

A. The cash value of each policy on March 1st, 1913, was $37.20, which is less than the total premiums paid to the anniversary in 1913. The share of each of the above policies in the aggregate sum provisionally ascertained and held awaiting apportionment was on March 1st, 1913, $6,800. The total value of each policy on that date, including the sum provisionally ascertained and held awaiting apportionment, was $44,100.

32nd Q. Do you know whether or not under the rules of the New York Life Insurance Company this policy could have been assigned by Dr. Alexander on March 1st, 1913?

77 A. The policy states at the bottom of the third page: "Any assignment of this insurance bond must be made in duplicate and both sent to the home office, the duplicate to be retained by the

company and the other to be returned. The company has no responsibility for the validity of any assignment."

33rd Q. The amount of the dividend provisionally ascertained, as you have stated, could not be determined by the company until after the experience of the company was known, could it? I mean during the period these policies were in existence.

A. The amount set aside at the end of each calendar year is determined from the experience of the preceding calendar year.

34th Q. Up to the time these policies matured it was only the company's experience that could determine how much would be reserved for those deferred dividends, while, on the other hand, the reserve on the policy itself was predetermined upon your mortality tables?

A. Yes.

35th Q. Then the reserve for the policy was a predetermined reserve, while that for the dividends had to be varied according to the experience of the company?

A. Yes. The policy reserve liability was determined according to standards set down by the insurance departments.

Redirect examination:

1st Q. The liability reserve on the policy is that calculated at 3% or 4%.

A. The minimum basis for the policy reserve liability which shall be held is specified in the insurance laws of New York State. The company has, however, at various times strengthened its reserves and, as permitted by law, has held more than the minimum basis.

2nd Q. Well, what is the minimum basis?

The March 1st, 1913, liability reserve—is that calculated at 3% or 4%?

(For answer see page 20-a.)

3rd Q. Where was the application for this policy written?

A. The application consists of two parts—one the part made directly to the New York Life Insurance Company and the other consisting of answers to the medical examiner and the medical examiner's report. Both are signed by the insured. The former was dated at Spring Station, Kentucky; the latter states that the
78 applicant was examined at Woodburn, Woodford County, Kentucky.

4th Q. Where was the policy delivered; at what place?

A. As far as I can determine from a brief inspection of the records, the policy was sent, in accordance with the company's practice, to the branch office in Kentucky to be delivered to the parties at interest.

5th Q. If Dr. Alexander had surrendered the policy to the company March 1st, 1913, how much money would he have received?

A. Under each policy he would have received $37,300, less any outstanding loans and unpaid loan interest.

6th Q. What substantial rights would he have lost under the contract if he had surrendered it on that date?

A. He would have received all that the contract of insurance provided that he would receive. He would, however, in accordance with the terms of the contract, lost any benefit which would accrue to him in later years from the dividends payable at maturity, no portion of which would be payable to him at surrender on March 1st, 1913.

7th Q. He would also have lost the $100,000 that he received on maturity of the policies, or part of it?

A. He would lose the excess of that over the value paid.

8th Q. What was the intrinsic worth of these insurance policies to Dr. Alexander on March 1st, 1913, according to their terms and provisions, assuming that he was going to keep them until maturity?

Mr. Horton. I object to that question on the ground that the intrinsic worth to him on March 1st, 1913, was what he could have received on March 1st, 1913, from the company for his policy.

A. The chief point at issue in this question is, I take it, the question of the accrued but unapportioned surplus. It is a question for the courts to determine whether some part of the surplus then apportioned to the policies should be considered, for the purposes at hand, to have accrued on March 1st, 1913. The facts are as already stated.

(Signed) WALTER GREGORY BOWERMAN.

79 Subscribed and affirmed to before me this 20th day of April, 1925.

[SEAL.] (Signed) MABEL E. CURRAN,
Notary Public, Kings County, No. 313, Registered Number 6138. Certificate Filed in New York County, No. 692, Register Number 6138A.

My commission expires March 30, 1926.

STATE OF NEW YORK,
County of New York.

I, Mabel E. Curran, a notary public within and for the above county and State, do certify that the foregoing depositions of Samuel L. Wilson and Walter Gregory Bowerman were taken before me at the time and place stated in the caption; that said witnesses were first duly sworn before giving it, and same was written by me in his presence, read to and subscribed by him in my presence. The plaintiff was present by Attorney Hamilton, and the defendant was present by Attorney Horton.

In testimony whereof I have hereunto set my hand and notarial seal this 20th day of April, 1925. My commission as notary public expires on the 30th day of March, 1926.

[SEAL.] (Signed) MABEL E. CURRAN,
Notary Public, Kings County, No. 313, Registered Number 6138. Certificate Filed in New York County, No. 692, Register Number 6138A.

My commission expires March 30, 1926.

Order settling bill of exceptions

And now, in furtherance of justice, and that right may be done, the defendant tenders and presents the foregoing as his bill of exceptions in this case to the action of the court, and prays that the same may be settled and allowed and signed and sealed by the court and made a part of the record, and the same is accordingly done this the 30 day of April, 1927.

CHAS. I. DAWSON, *Judge.*

Approved April 30, 1927.
ELWOOD HAMILTON, *Atty. for Plf.*
T. J. SPARKS, *Atty. for Deft.*

80 In United States District Court

Plaintiff's petition for writ of error

Filed May 11, 1927

And now comes A. J. A. Alexander, plaintiff herein, and says that on or about the 9th day of March, 1927, this court entered judgment herein in favor of the plaintiff, in which judgment and the proceedings had prior thereto in this cause certain errors were committed to the prejudice of this plaintiff, all of which will more in detail appear from the assignment of errors which is filed with this petition.

Wherefore plaintiff prays that a writ of error may issue in this behalf out of the United States Circuit Court of Appeals for the Sixth Circuit for the correction of errors so complained of and that a transcript of the record, proceedings, and papers in this cause duly authenticated may be sent to the said Circuit Court of Appeals.

BECKHAM, HAMILTON & BECKHAM,
Attorneys for Plaintiff.

In United States District Court

Plaintiff's assignment of errors

Filed May 11, 1927

The plaintiff makes the following assignments of errors, which he avers occurred in the trial of this cause, and prays for a reversal of the decree of the District Court and for judgment as prayed for in his original petition:

First. The court erred in holding that the plaintiff realized any gain or taxable income out of the sum received, to wit, $120,797.00, from the New York Life Insurance Company on the surrender of the two insurance policies on May 19, 1919.

Second. The court erred in holding that the two insurance
81 policies above referred to had a value March 1, 1913, of only $93,587.81, when in fact said policies had a value March 1, 1913, of $115,311.00.

BECKHAM, HAMILTON & BECKHAM,
Attorneys for plaintiff.

In United States District Court

Defendant's petition for writ of error

Filed May 11, 1927

And now comes Robert H. Lucas, as collector of internal revenue for the district of Kentucky herein, and says that on or about the 9th day of March, 1927, this court entered judgment herein in favor of the plaintiff and against this defendant in which judgment and the proceedings had prior thereto in this cause, certain errors were committed to the prejudice of this defendant, all of which will more in detail appear from the assignment of errors which is filed with this petition.

The defendant states that the above-entitled cause is one in which the United States and not the record defendant is the real party in interest in said cause, and this appeal is being taken by direction of the Department of Justice of the United States of America.

Wherefore this defendant prays that a writ of error may issue in this behalf out of the United States Circuit Court of Appeals for the Sixth Circuit, for the correction of errors so complained of, and that a transcript of record proceedings and papers in this cause, duly authenticated, may be sent to the said Circuit Court of Appeals.

T. J. SPARKS,
United States Attorney.
Attorney for Defendant.

82 In United States District Court

Defendant's assignment of errors

Filed May 11, 1927

Comes now the defendant in the above-entitled cause, Robert H. Lucas, as collector of internal revenue for the district of Kentucky, and presents to the court his assignment of errors which he alleges were committed in the trial and proceedings in the above cause to his prejudice and injury, as follows:

1. The court erred in adjudging that the fair cash value of the two insurance policies in controversy was $93,587.81 on the 1st day of March, 1913.

2. The court erred in fixing the value of said two insurance policies as of March 1st, 1913, in any greater sum than $78,100.00.

3. The court erred in adjudging that the amount of profit derived by plaintiff from said two insurance policies as of May 19th, 1919, was only $27,209.19.

4. The court erred in refusing to adjudge that the profit derived by plaintiff from said two insurance policies as of May 19, 1919, was any less than $42,697.00.

5. The court erred in giving plaintiff judgment for the sum of $6,519.36.

6. The court erred in refusing to dismiss plaintiff's petition on final hearing and giving to defendant judgment for his cost in this action expended.

Wherefore defendant prays that said decision be reversed and that the said court may be directed to enter decree in accordance with the prayer of defendant's answer; that is, that the plaintiff's petition herein be dismissed.

T. J. SPARKS,
United States Attorney,
Attorney for Defendant.

63 In United States District Court

Order allowing writ of error for both plaintiff and defendant, May 11, 1927

On the 11th day of May, 1927, the above-named plaintiff, A. J. A. Alexander, appearing by Elwood Hamilton, his attorney, and the above-named defendant, Robert H. Lucas, collector of internal revenue for the district of Kentucky, appearing by T. J. Sparks, United States attorney, his attorney, and each party filed herein and presented to the court their petitions praying for the allowance of writs of error and assignments of error intended to be urged by each of them; and also, that a transcript of the record and proceedings and papers upon which the judgment herein was rendered, duly authenticated, be sent to the United States Circuit Court of Appeals for the Sixth Circuit, and that such other and further proceedings may be had as may be proper in the premises.

To the filing of the petition and for the allowance of the writ of error on behalf of the defendant, Robert H. Lucas, collector of internal revenue for the district of Kentucky, the plaintiff, A. J. A. Alexander, objected on the ground that the petition and assignment of error had not been filed by the defendant before the settling of the bill of exceptions herein, and the court, being advised, overruled said objection to which the plaintiff objected and excepted.

And on consideration thereof, the court does now allow the writ of error as prayed in the petitions of both plaintiff and defendant, the petition of the defendant being granted without bond, it appearing that the above-entitled cause is one in which the United States and not the record defendant is the real party in interest in said cause, and this appeal on behalf of the defendant being taken by direction of the Department of Justice of the United States of America.

84 **In United States District Court**

Stipulation re record

Whereas it appears in the above-entitled cause from the record herein that in the preparation of the bill of exceptions there was omitted an answer to a question propounded by the attorney for the plaintiff in error on cross-examination of the witness, Walter Gregory Bowerman, which question is numbered No. 20. The answer as it appears in said deposition is as follows:

"No. The policy specifically states that no dividends shall be apportioned to the policy prior to the 19th day of May, 1919."

This omission was merely an oversight in copying said deposition as a part of the bill of exceptions herein.

And whereas it further appears that the plaintiff in error omitted to include in the præcipe motion for judgment on behalf of defendant, filed in the court below, June 10, 1926, which motion should be a part of the record herein;

And whereas, on account of said omissions, the clerk of the court below was unable to include in the record sent up to this court that part of the bill of exceptions and that part of the record hereinbefore described,

It is now herein agreed by the parties, through and by their respective counsel, that the record in this cause, filed by the clerk on the ——— day of June, 1927, be amended by attaching thereto the omitted part of the bill of exceptions and the omitted part of the record hereto attached and marked "Exhibit A," to this stipulation, and that the same may be filed in this court as part of the record herein and in so far shall have the same effect as if the record herein filed had been complete at the time.

There is attached hereto and made a part hereof the omitted answer as it appears in the deposition hereinbefore described, and the omitted motion for judgment on behalf of defendant, certified as being true and correct copies of part of this record by the clerk of the court below.

This the 7th day of June, 1927.

T. J. Sparks,
U. S. Atty., Counsel for Plaintiff in Error.
Elwood Hamilton,
Counsel for Defendant in Error.

Approved:
Denison, J.

85 (Stamped on back:) Filed Jun 8, 1927. Arthur B. Mosman, clerk.

The answer to question No. 20, in the cross-examination of witness Walter Gregory Bowerman, as found on page 28 of the bill of

exceptions heretofore filed. The answer to said question in words and figures is as follows:

"No. The policy specifically states that no dividends shall be apportioned to the policy prior to the 19th day of May, 1919."

UNITED STATES OF AMERICA,
Western District of Kentucky, ss:

I, Lilburn Phelps, clerk of the District Court of the United States for the Western District of Kentucky, certify that the last foregoing paragraph enclosed in quotation marks is a correct copy of answer to question No. 20, in the cross-examination of Walter Gregory Bowerman, as appears from the original deposition on file in my office in case at law No. 788, wherein A. J. A. Alexander is plaintiff, and Robt. H. Lucas, collector of internal revenue for the district of Kentucky, is defendant, as appears from the original on file in my office. This June 7th, 1927.

[SEAL.] LILBURN PHELPS, *Clerk.*

In United States District Court

Motion for judgment on behalf of defendant

Now comes defendant herein before judgment and moves the court to enter judgment in his favor and against plaintiff herein for the following reasons, to wit:

First. That plaintiff has adduced in this case no substantial evidence which would warrant a judgment in his favor and against this defendant.

Second. That on March 1, 1913, there had not been credited to plaintiff by the New York Life Insurance Company on his policies of insurance any portion of the earnings and profits of said company.

Third. That under the revenue act of 1918 the March 1, 1913, market price or value of plaintiff's policies of insurance with the New York Life Insurance Company did not exceed the total premiums paid by him to said company on said policies, to wit, $78,100.00.

Fourth. That plaintiff, under the revenue act of 1918, on the surrender of his policies of insurance in the calendar year 1919 to the New York Life Insurance Company for the sum of $120,797.00 in cash realized taxable gain, income, or profits in said calendar year 1919 of the difference between the total premiums paid by him, $78,100.00, and said cash surrender value of $120,797.00, amounting to the sum of $42,697.00.

Fifth. That the additional taxes for the calendar year 1919, paid by plaintiff and sought to be recovered by him in this action, were

lawfully assessed and legally collected, and by reason thereof plaintif is not entitled to recover any part thereof as against this defendant.

Respectfully submitted.

W. S. Bailey,
United States Attorney,
Attorney for Defendant.

E. H. Horton,
Attorney, Bureau of Internal Revenue, of Counsel.

[Certificate to foregoing paper omitted in printing.]

87 In United States District Court

Writ of error

United States Circuit Court of Appeals for the Sixth Judicial Circuit, ss:

The President of the United States to the honorable the Judge of the District Court of the United States for the Western District of Kentucky, Greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you or some of you, between A. J. A. Alexander and Robert H. Lucas, collector of internal revenue for the district of Kentucky, a manifest error hath happened, to the great damage of the said Robert H. Lucas, collector of internal revenue for the district of Kentucky, as by his complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the clerk of the United States Circuit Court of Appeals for the Sixth Circuit, together with this writ, so that you have the same at Cincinnati, Ohio, in said circuit, on the * 10 day of June next,

88 in the said Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error, what of right, and according to the law and customs of the United States, should be done.

Witness the honorable William H. Taft, Chief Justice of the United States, the 11th day of May, in the year of our Lord one thousand nine hundred and twenty-seven, and of the independence of the United States of America the one hundred and fifty-first.

Lauren Pierce,
Clerk of the District Court of the United States,
Western District of Kentucky.

Allowed by

———— ————, *Judge.*

* Not exceeding 30 days from the day of signing the citation.

In United States District Court

Cross-writ of error

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH JUDICIAL CIRCUIT.

The President of the United States to the honorable the Judge of the District Court of the United States for the Western District of Kentucky, Greeting:

Because in the record and proceedings, as also in the rendition of the judgment of a plea which is in the said District Court, before you or some of you, between A. J. A. Alexander and Robert H. Lucas, collector of internal revenue for the district of Kentucky, a manifest error hath happened, to the great damage of the said A. J. A. Alexander, as by his complaint appears. We being willing that error, if any hath been, should be duly corrected, and full and speedy justice done to the parties aforesaid in this behalf, do command you, if judgment be therein given, that then under your seal, distinctly and openly, you send the record and proceedings aforesaid, with all things concerning the same, to the clerk of the United States Circuit Court of Appeals for the Sixth Circuit together with this writ, so that you have the same at Cincinnati, Ohio, in said circuit, on the* 10 day of June next, in the said Circuit Court of Appeals, to be then and there held, that the record and proceedings aforesaid being inspected, the said Circuit Court of Appeals may cause further to be done therein to correct that error, what of right, and according to the laws and customs of the United States, should be done.

Witness the honorable William H. Taft, Chief Justice of the United States, the 11th day of May, in the year of our Lord one thousand nine hundred and twenty-seven and of the independence of the United States of America the one hundred and fifty-first.

LILBURN PHELPS,
Clerk of the District Court of the United States,
Western District of Kentucky.

Allowed by

——— ———, *Judge.*

In United States District Court

Waiver of citation

Citation to defendant in error and to plaintiff on cross error to writ of error filed in the clerk's office on May 11, 1927, in the above-styled action is hereby waived by both plaintiff and defendant in error.

T. J. SPARKS,
Attorney for Plaintiff in Error.
ELWOOD HAMILTON,
Attorney for Defendant in Error.

*Not exceeding 30 days from the day of signing the citation.

In United States District Court

Defendant's praecipe

Filed May 23, 1927

You are requested to take a transcript of record to be filed in the United States Circuit Court of Appeals for the Sixth Circuit pursuant to writ of error allowed in the above-styled case, and to include in such transcript of record the following and no other papers or exhibits, to wit:

Petition, including exhibits filed therewith as part thereof;
Amended petition;
Answer;
Amended petition;
Amended answer;
Order permitting depositions to be taken;
General demurrer;
Judgment and finding of fact;
Order extending time for filing bill of exceptions;
Bill of exceptions;
Order filing bill of exceptions;
Plaintiff's petition for writ of error;
Plaintiff's assignment of errors;
Defendant's petition for writ of error;
91 Defendant's assignment of errors;
Order allowing writ of error for both.

Respectfully,

T. J. SPARKS,
United States Attorney,
Attorney for Defendant.

In United States District Court

Clerk's certificate

I, LILBURN PHELPS, clerk of the District Court of the United States for the Western District of Kentucky, do hereby certify that the foregoing transcript of record, consisting of 90 pages, contains a full, true, and complete copy of all pleadings, record entries, and proceedings in the case of A. J. A. Alexander versus Robert H. Lucas, collector of internal revenue for the district of Kentucky, made and copied in accordance with the praecipe of counsel copied on page 90 of this record as the same appears from the original thereof on file and of record in my said office.

It is further certified that no præcipe was filed by counsel for plaintiff, A. J. A. Alexander, and his counsel advised the clerk that none would be filed.

[SEAL.] LILBURN PHELPS, *Clerk.*

92 [Appearance of counsel omitted in printing.]

In United States Circuit Court of Appeals, Sixth Circuit

Motion to dismiss

Filed Dec. 22, 1927

The appellee moves the court to dismiss the appeal filed herein—

First. Because the appellant filed its bill of exceptions in the lower court on April 30, 1927 (R. p. 52), and its assignment of errors May 11, 1927, in violation of rule 10 of this court, and he asks that this motion be passed to the hearing on the merits.

BECKHAM, HAMILTON & BECKHAM,
Attorney for Appellee.

I have this day received a copy of the above motion, December 21, 1927.

FRANK A. ROPKE,
Attorney for Appellant.

93 [Minute entry of argument and submission Feb. 17, 1928, omitted in printing.]

In United States Circuit Court of Appeals, Sixth Circuit

Judgment

Filed June 30, 1928

Error to the District Court of the United States for the Western District of Kentucky.

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Western District of Kentucky and was argued by counsel.

On consideration whereof it is now here ordered and adjudged by this court that the judgment of the said district court in this cause be, and the same is hereby, affirmed.

94 [File endorsement omitted.]

Nos. 4973, 4974

In United States Circuit Court of Appeals, Sixth Circuit

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT of Kentucky, plaintiff in error in No. 4973, defendant in error in No. 4974

against

A. J. A. ALEXANDER, DEFENDANT IN ERROR IN No. 4973, PLAINTIFF IN error in No. 4974

Error and cross error to the District Court of the United States for the Western District of Kentucky. Decided June 30, 1928

Opinion

Filed June 30, 1928

Before DENISON, MACK, and MOORMAN, Circuit Judges.

MACK, Circuit Judge: Error and cross error from a judgment for plaintiff in the sum of $6,519.36, with interest, part of an additional assessment collected from him as income tax for the year 1919.

The New York Life Insurance Company, a mutual company, issued to plaintiff, then aged 24, two policies, effective May 19, 1899, in the aggregate face amount of $100,000.00, called "insurance bond with guaranteed interest." The annual premium was $7,810.00. In case of death within the first ten years only the face amount, $100,000.00, was to be paid; if death occurred within the second ten years, the amount payable would be in excess of $100,000.00, a guaranteed sum increasing year by year, and reaching a maximum of $144,300.00 in the twentieth year. In case of death during the year which included March 1, 1913—that is, the year ending May 19, 1913—$114,000.00 would thus have been payable. If the insured was alive at the end of the twentieth year—that is, on May 19, 1919—

the face of the policy became payable, and in addition
95 thereto a cash dividend then to be apportioned by the company.

Certain optional rights were given at the end of the twentieth year, but they are not important for the purposes of this case. The policy was payable to the estate of the insured; he had the right to change the beneficiary.

The guaranteed loan or cash surrender value which began in the third year amounted to $79,400.00 in the year ending May 19, 1913. In order fairly to determine the dividend apportionable at the end of 20 years the company kept a record called "Funds provisionally ascertained and held awaiting apportionment" for each policy. This provisional fund increased yearly; to it were allocated the dividends that would otherwise have been paid annually with the interest

earned thereon and the pro rata share of the similarly provisionally accumulated dividends of those policyholders in the same class who died before the end of the 20-year period. On March 1, 1913, the company had thus provisionally set aside on its books $13,600.00 for plaintiff's policies. As of that day, its accountants would have estimated that on the assumption of surplus increase during the ensuing six years at the same rate as during the past fourteen years the dividend payable to plaintiff, if alive on May 19, 1919, would be $19,428.57. The actual course of events was that the rate of increase of the surplus was accelerated during the next six years, so that the amount actually paid to plaintiff in 1919 was $20,797.00 in addition to the $100,000.00 face amount of the policies.

Of the amount plaintiff received, he reported $17,238.35 as income for the year 1919, claiming that the remaining $103,560.65 represented the March 1, 1913, value of his policy. The Commissioner of Internal Revenue, reauditing his return, found the taxable gain to have been $42,697.00, the difference between the amount received, $120,797.00, and the amount paid out in premiums during the 20 years, $78,100.00. Value as of March 1, 1913, was disregarded. Pursuant to demand, plaintiff paid an additional assessment of $8,750.91 and brought this action for its return.

The district court found the taxable gain $27,209.19 over the March 1, 1913, valuation of $93,587.81 on this reasoning: As plaintiff on March 1, 1913, was normally healthy and thirty-eight years old, the chances of his living out the full 20 years and then receiving $119,428.57 in the policies were very good. Discounting that sum at the rate of 4% annually for the six years 2 months and 19 days gave $93,587.81, the value on March 1, 1913, as found by the court.

96 The applicable statutory provisions are sections 202 and 213 of the revenue act of 1918, 40 Stat. 1060, 1065, as follows:

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; * * *

SEC. 213. That for the purpose of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

(b) Does not include the following items, which shall be exempt from taxation under this title:

(1) The proceeds of life-insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract. * * *

Regulations 45 (1920 edition) provide in article 72b: "During his life only so much of the amount received by an insured under life, endowment, or annuity contracts as represents a return, without interest, of premiums paid by him therefor is excluded from his gross income."

It is contended by plaintiff that the proceeds of life-insurance policies are not constitutionally taxable as income, but that if they are then the correct method of determining the taxable gain in the present case is to subtract from the amount received a sum equal to the face of the policy plus the dividends which had been provisionally determined by March 1, 1913. Defendant contends
97 that the policies are taxable, at the difference between the amount received and either the amount of premiums paid or the cash surrender value on March 1, 1913.

Plaintiff contends that the proceeds of life-insurance policies do not constitute income within the Sixteenth Amendment. In United States v. Supplee-Biddle Hardware Company, 265 U. S. 189, the Supreme Court expressly refrained from deciding whether life insurance paid on the *death* of a corporate officer could constitutionally be taxed as income to the corporation which had insured him. The instant policy is an endowment; payment thereof was made in the lifetime of Alexander, to himself. The policy, like all endowment policies, was a combination of life insurance and investment. When paid, there enured a clear profit to the insured, a profit that is as much income within the constitutional amendment as any profit gained in a business transaction. The provisions of the 1918 act above quoted are clearly broad enough to include gains from insurance transactions other than the two specific exemptions.

The second question is as to the applicability of Treasury Regulation 45, article 72b, under which the commissioner proceeded. Attempts to support it on the ground of settled administrative practice must fail, not only because the Government relies for proof of the continuity of the practice upon later regulations promulgated after the assessment in dispute and under different statutes, but also because the regulation is contrary to law in so far as it attempts to regulate income tax on proceeds of insurance policies having a fair market price or value on March 1, 1913. The act which it interprets says that to ascertain gain from the disposition of property, the excess over the March 1, 1913, fair market price or value of that property should be taken. An insurance policy is of course property

within the statute. Its value as property is not necessarily equal to its cost; it may as well be more or less.

We come, then, to the question of the March 1, 1913 value of the policies. Defendant contends for surrender value on the ground that the only way the insured could have realized on his policies in 1913 was by surrendering them. Plaintiff contends for the then value to the insured because of the lack of a market price, due to their non-assignability to a stranger. That value, plaintiff further contends, was $113,600.00, the face of the policies plus $13,600.00 of surplus then provisionally credited to him on the company's books, since it was reasonably certain that plaintiff would get at least that sum.

He argues that the probability of further additions to surplus
98 during the time plaintiff had to wait for the money neutralized the six years' postponement of enjoyment, so that no discounting was necessary to find present value.

The only reported litigation involving the valuation of an insurance policy for Federal income-tax purposes which has been found is Appeal of Kline, 3 B. T. A. 1138. There the taxpayer held a policy of the New York Life Insurance Co. in the amount of $10,000.00, issued in 1902 and fully paid up in 1912 by ten annual premiums of $965.20, on which policy no dividends or other distribution was to be made until 1922, when the insured exercised the option to receive $14,830.10 in cash. The surrender value March 1, 1913, was $9,070.00. The commissioner based the tax for 1922 upon the difference between the surrender value on March 1, 1913, and the total paid in 1922. He was sustained by the Board of Tax Appeals. However, the sole ground of the taxpayer's appeal was that the amount of premiums paid should have been subtracted rather than the surrender value. A method similar to that employed by the district judge in the present case was not urged and would have been still more unfavorable to the taxpayer.

Kentucky Tobacco Products Co. v. Lucas, 5 Fed. (2d) 723, involved the valuation as of March 1, 1913, for the purpose of measuring depreciation under the income tax of a contract right to make future purchases of raw materials at highly advantageous prices. The method of valuation employed was to find how much profit would be received by the taxpayer under the contract during the years it had to run and then to take the present value in 1913 of this amount by discounting on a 5% interest basis.

Plaintiff's situation on March 1, 1913, was as follows: If he lived until 1919, he could reasonably expect then to realize about $120,000 on the policies. The present value of that sum we may take as $93,587.81, since the details of the trial judge's calculations are unimpeached. The amount payable to the estate in case of death between March 1, 1913, and May 19, 1919, would have ranged from a minimum of $114,000 to a maximum of $144,000.

It follows, therefore, if the policy had been salable its market value on March 1, 1913, would clearly have been no less than $93,587.81, the then discounted value of the amount in all probability payable at maturity, inasmuch as the purchaser would have had an

excellent investment with the chance of a very heavy increase in case the insured died before maturity.

If an assignable policy were worth this amount in the market, then the nonassignable policy was worth the same amount to the insured.

99 It is true that plaintiff could have realized only $79,400.00 from the policies by surrendering them. But he was under no obligation to make this less advantageous disposition of his property. The statement in In re Newland, 18 Fed. Cas. 92, approved in Hiscock v. Mertens, 205 U. S. 202, 212, that the present value of an insurance policy is its surrender value, was a dictum with reference to valuation for bankruptcy purposes. It involves wholly different considerations. The loan or surrender value of plaintiff's policies was not a "market price." Moreover, section 202 does not make market price the sole criterion; it permits deduction of fair market price or *value*, and since the latter phrase is set in opposition to the former, value to the owner may be taken as the alternative to market price.

Plaintiff Alexander's assignments of error in No. 4974 are without merit. The attempt is made, by reasoning not entirely clear, to take the face of the policy plus the provisionally apportioned dividends as the value in 1913. If the theory of this is that plaintiff was sure to get at least that amount in 1919, there is the obvious objection that plaintiff has lost sight of the fact that a future accruing sum must be discounted to find its present value. If, on the other hand, plaintiff's theory is that the provisionally credited dividends in 1913 represented in part the intrinsic value of the policy, this runs counter to New York Life Insurance Co. v. Edwards, 271 U. S. 109, affirming 8 Fed. (2d) 851, which made clear that holders of policies such as the one here in question have absolutely no interest in such dividends until the maturities of their policies.

Judgment affirmed.

100 In United States Circuit Court of Appeals

Motion to stay mandate

Filed July 25, 1928

Now comes plaintiff in error in No. 4973 and defendant in error in No. 4974 and moves the court to stay issuance of mandate in said appeals until September 3rd, 1928.

FRANK A. ROPKE,
Counsel for Plaintiff in Error, No. 4973;
Defendant in Error, No. 4974.

Service accepted and receipt of copy of the motion to stay proceedings received this ——— day of July, 1928.

(Signed) ELWOOD HAMILTON,
Counsel for Defendant in Error, No. 4973;
Plaintiff in Error, No. 4974.

In United States Circuit Court of Appeals

Motion to stay mandate

Filed Aug. 22, 1928

Now comes plaintiff in error in No. 4973 and defendant in error in No. 4974 and moves the court to stay issuance of mandate in said appeals until September 30, 1928.

FRANK A. ROPKE,
Counsel for Plaintiff in Error, No. 4973;
Defendant in Error, No. 4974.

Service accepted and receipt of copy of the motion to stay proceedings received this 20th day of Aug., 1928.

(Signed) ELWOOD HAMILTON,
Counsel for Defendant in Error, No. 4973;
Plaintiff in Error, No. 4974.

[Clerk's certificate to foregoing transcript omitted in printing.]

102 Supreme Court of the United States

Order allowing certiorari

Filed November 19, 1928

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Indorsement on cover:) File No. 33,790. U. S. Circuit Court of Appeals, Sixth Circuit. Term No. 481. Robert H. Lucas, Collector of Internal Revenue for the District of Kentucky, petitioner, *vs.* A. J. A. Alexander. Petition for writ of certiorari and exhibit thereto. Filed September 28th, 1928. File No. 33,790.

○

On May 19, 1919, Rep received $120,797.00 - face of policies and dividends of $20,797.00

Rev Com'n computed gain as follows:

120,797.00 - Received
78,100.00 - paid on Mar 1, 1913
$42,697.00 gain

Rev de computed —

120,797.00 - Received - and deducted therefrom Mar 1, 1913 value arrived at which he computed as follows:
93,577.81
$27,219.19

as of Rep. was [illegible]
3-1-13 [illegible]
$ 119,438.51 - capitalized at 4% gave present worth on Mar 1, 1913 of 93,577.81
[illegible] 3-1-1913

Supporting that Conclusion Cla paid:

1 Rev determining question is Mar 1, 1913 value Amount [illegible] 3-1-13 and May 19, 1919 would have ranged from 114,000 to 124,000/ If he lived we would not get that sum but dividend accumulations. To discount those accumulations would be to arrive at very fair value - if insured lived the accumulations - if he died, the heavy increase in face value

2 Cada [illegible] 3-1-13 [illegible]

Two argues:

§ 213 gives a definition of taxable gain. It makes a special definition for insurance policies [illegible] Regs [illegible] must be followed rather than [illegible]

Congress took Cost Rather Than cash surrender value as fourth method, eliminating [illegible]

But if you do follow § 202, the definition of Market Value is wrong. It is based upon a Contingency - Receipt of premiums - which may or may not occur.

[illegible] - after full payment of premiums
20 other companies varying amts payable to insured in case of death prior to end of accumulation period
[illegible] $144,500

It also specified Cash surrender or guaranteed loan values.

$1104,000 would never been payable in case of death.

On Jan 1, 1913, the situation was this:

Resp. was 35 yrs. old, normally healthy & with good expectations of living out the term. He had paid out $8,100 in premiums. His policies had Cash surrender values of 79,400. [illegible] 1-1913, 13,600 at once provisionally [illegible] and normal expectation was it would amount to 19,495.57

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In the Supreme Court of the United States

OCTOBER TERM, 1928

No.———

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE for the District of Kentucky, petitioner

v.

A. J. A. ALEXANDER

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of Robert H. Lucas, former Collector of Internal Revenue for the District of Kentucky, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit entered in the above case on June 30, 1928, affirming the judgment of the District Court of the United States for the Western District of Kentucky.

QUESTION PRESENTED

What taxable gain was realized by the taxpayer under the provisions of Sections 213 (b) (2) and 202 (a) (2) of the Revenue Act of 1918, *infra*, upon surrender by him, at maturity, May 19, 1919, of two

participating, deferred dividend policies issued to him on May 19, 1899?

STATUTES AND REGULATION INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057:

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *.

(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * *

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

* * * * *

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be:

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *.

Regulations 45 (1920 Edition), Art. 72 (b):

> During his life only so much of the amount received by an insured under life, endowment or annuity contracts as represents a return, without interest, of premiums paid by him therefor is excluded from his gross income.

STATEMENT

Respondent on June 5, 1899, was issued, effective May 19, 1899, two policies of life insurance by the New York Life Insurance Company. (R. 16–30.) The face value of each policy was $50,000.00. (R. 16, 23.) Each was a participating deferred dividend policy called "Insurance bond with guaranteed interest." (R. 16, 23.) The accumulation period of each was twenty years. (R. 17, 24.) The policies were fully paid up on March 19, 1908, after ten premium payments aggregating $78,100 had been paid. (R. 53.)

The policies provided for certain payments in the event of the death of the insured during the accumulation period (R. 21, 28); and for certain accumulation guarantees and benefits if the insured lived to the end of the accumulation period (R. 22, 29–30). Each policy contained the following provisions:

> This Insurance Bond participates in surplus as hereinafter provided, *but no dividend shall be apportioned to it before the end of the Accumulation Period.* (R. 53.)
>
> * * * * *
>
> The Accumulation Period of this Insurance Bond ends on the nineteenth day of May in the year nineteen hundred and nineteen. If

> the insured is living; and if the premiums have been duly paid to that date, and not otherwise, THE COMPANY WILL THEN APPORTION A DIVIDEND TO THE INSURED * * *. (R. 54.)
>
> * * * * *
>
> The Company guarantees that the entire cash value of this Insurance Bond at the end of the Accumulation Period shall be Fifty thousand Dollars, and in addition the cash dividend *then apportioned by the Company*. (R. 54.) (Italics supplied.)

The taxpayer being alive at the maturity of the policies on May 19, 1919, he elected to receive the cash surrender value of the policies, and, on surrendering the policies, was paid by the insurance company the sum of $120,797. (R. 55.) The aggregate dividends then apportioned amounted to $20,797 for the two policies. (R. 22, 30.)

He returned for taxation as income $17,290.35, claiming that the remaining $103,506.65 represented the March 1, 1913, value of his policies. (R. 11.)

The Commissioner of Internal Revenue found that the taxable gain was $42,697, the difference between the sum received, $120,797, and the total of premiums paid, $78,100, without interest. (R. 55.) A deficiency tax of $11,334.17 was assessed, of which respondent paid, under protest, $8,750.91 (R. 55), and thereafter brought suit in the District Court of the United States for the Western District of Kentucky for its recovery (R. 1, 44).

The loan value of each of the policies on March 1, 1913, was $37,300 (R. 21, 29), a total of $74,600.

This loan value was the equivalent of a cash surrender value. (R. 68.) The record of the insurance company shows that on March 1, 1913, the share of each of these policies in "the aggregate sum provisionally ascertained and held awaiting apportionment" was $6,800 (R. 68), a total of $13,600.

The District Court determined the March 1, 1913, value of these policies as follows:

The policies being fully paid up, the insurance company had provisionally set aside certain sums as the accumulation on these policies which, on March 1, 1913, amounted to $13,600. Assuming that the same rate of accumulation would continue, it appeared at that time that this amount would grow by May 19, 1919, to the sum of $19,428.57, which, added to the face value of the policies, would make a total estimated value of $119,428.27. The present value of this sum on March 1, 1913, at 4 per cent per annum compounded annually was found to be $93,587.81, and this sum deducted from the amount actually received, $120,797, gave $27,209.19 as the taxable gain. (R. 42–43.) Judgment was rendered for the plaintiff on this basis. (R. 44.)

The Circuit Court of Appeals for the Sixth Circuit, on writ of error, affirmed the judgment of the court below, and sustained the method adopted by the lower court in determining the March 1, 1913, market price or value of said policies as $93,587.81. (R. 93.) It held that Article 72 (b) of Treasury Regulations 45 (1920 Edition) is "contrary to law in so far as it attempts to regulate income tax on

proceeds of insurance policies having a fair market price or value on March 1, 1913." (R. 96.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred in holding that the taxable gain realized by the taxpayer, upon surrender by him at maturity of the two insurance policies involved in this case, was only $27,209.19; and in failing to hold, under the provisions of Sections 213 (b) (2) and 202 (a) (2), Revenue Act of 1918, *supra*, that the taxable gain realized by the taxpayer was the difference between the sum paid him by the insurance company, $120,797, and the total of premiums paid, $78,100, without interest, or $42,697.

REASONS FOR GRANTING THE WRIT

1. The Circuit Court of Appeals has decided in this case an important question of Federal taxation, which has not been, but should be, settled by this Court.

2. The Circuit Court did not apply or construe an applicable provision of the statute, which would seem to be controlling in cases of this nature, Sec. 213 (b) (2), Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065.

3. The decision of the Circuit Court of Appeals is not in harmony with important principles announced by this Court in analogous cases—*Penn Mutual Life Insurance Co.* v. *Lederer*, 252 U. S. 523, 529; *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109.

4. The decision of the Circuit Court of Appeals is contrary to the rulings of the United States Board of Tax Appeals—*Appeal of E. A. Armstrong*, 1 B. T. A., 296; *Appeal of Kline*, 3 B. T. A. 1138; *Chamansky* v. *Commissioner*, 8 B. T. A. 1276; and also opposed to the long-continued departmental construction of the statute.

5. The case is one of great public interest and of great importance to the Government in the administration of the revenue laws, since the decision of said Circuit Court of Appeals affects the taxability of the proceeds of every life insurance policy, annuity, or endowment contract issued prior to March 1, 1913, and paid to the insured during his lifetime. In order that the revenue laws may be properly administered by the Treasury Department, an authoritative decision by this Court is necessary.

WHEREFORE, it is respectfully submitted that this petition for writ of certiorari to review the judgment of the Circuit Court of Appeals for the Sixth Circuit should be granted.

WILLIAM D. MITCHELL,
Solicitor General.

SEPTEMBER, 1928.

12466—28——2

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The opinion of the District Court of the United States for the Western District of Kentucky (R. 37–44) is reported in 21 F. (2d) 68. The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 93) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Sixth Circuit was entered on June 30, 1928. (R. 93.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATEMENT

A statement of the facts and of the errors relied on will be found in the petition.

ARGUMENT

I

THE DETERMINATION OF TAXABLE GAIN IN THIS CASE IS GOVERNED BY A SPECIAL PROVISION OF THE STATUTE

After providing by Section 213 (a) of the Revenue Act of 1918, 40 Stat. 1057, 1065, for the inclusion in gross income of "gains or profits and income derived from any source whatever," and that "the amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer," Congress, in subsection (b) (2) of said Section 213, enacted a special provision for the determination of taxable gain or net income derived by the insured

from any life insurance, endowment, or annuity contract during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract. It was there provided that gross income did not include, and that there should be exempt from taxation,

> The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

In thus providing for the noninclusion in gross income of the amount received by the insured as a return of premiums, Congress was evidently proceeding on the theory that such premiums represented the cost of the insurance contract. It clearly intended that amounts received by the insured in excess of premiums paid should be included in gross income and taxed in the year in which received.

Article 72 (b) of Regulations 45 (1920 Edition), duly promulgated by the Treasury Department under said Revenue Act of 1918, provides:

> During his life only so much of the amount received by an insured under life, endowment or annuity contracts as represents a return, without interest, of premiums paid by him therefor is excluded from his gross income.

The Commissioner of Internal Revenue based his determination of respondent's net income for the year 1919, in so far as it was derived from these insurance

policies, upon said Section 213 (b) (2) and said Article 72 (b) of said Regulations 45.

The Circuit Court of Appeals held (R. 96):

> • • • the regulation is contrary to law in so far as it attempts to regulate income tax on proceeds of insurance policies having a fair market price or value on March 1, 1913.

This can only mean that, in the opinion of the Circuit Court of Appeals, the regulation is contrary to the provisions of Section 202 (a) (1) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060. Clearly the regulation is not contrary to Section 213 (b) (2) of the said Act, for it is in practically the same language. If the regulation is contrary to law and void, then it would seem to follow that said Section 213 (b) (2), in so far as it applies to insurance policies issued prior to March 1, 1913, is unconstitutional and void. Otherwise it must be accepted as controlling; for Section 202 (a) (1) and (2) of the said Revenue Act of 1918 are general provisions relating to the computation of taxable gain from the sale or other disposition of property, and Section 213 (b) (2) is a specific provision relating to the same subject matter when the gain is derived from the disposition of life insurance, endowment, or annuity contracts.

It is a well-recognized rule of statutory construction that when there is a general and a specific provision of a statute relating to the same matter the specific provision will be construed as "qualifying and supplying exceptions to the general." *Townsend* v. *Little*, 109 U. S. 504, 512.

Construed as an exception to the general provisions of said Section 202 (a) (1), the Circuit Court of Appeals and the District Court should have accepted said Section 213 (b) (2) and the regulations adopted pursuant thereto as controlling, and as the basis for determining the taxable gain from the policies here in question.

II

SEC. 213 (B) (2) OF THE REVENUE ACT OF 1918 IS NOT UNCONSTITUTIONAL AS APPLIED TO LIFE INSURANCE, ENDOWMENT, OR ANNUITY CONTRACTS ISSUED PRIOR TO MARCH 1, 1913

In providing that of the sum received by an insured during his lifetime on life insurance, endowment, or annuity contracts, only the amount or amounts paid as premiums should be exempt from taxation as income, Congress was not exceeding its authority, notwithstanding the fact that the contract may have been issued prior to March 1, 1913. This allowance is favorable to the taxpayer, for, as illustrated by this case, it creates an exemption greater than the cash surrender value of the policy. On March 1, 1913, the cash surrender value of the two policies in question was only $74,600, whereas the total of the premiums paid was then $78,100. (R. 21, 29, 55.)

In so limiting the sum exempt from taxation Congress was merely excluding speculative values depending on various contingencies, such as the solvency or continued solvency of the company issuing the contracts, its earning capacity, the keeping up of premium payments, the probability that the insured

would live to the end of the accumulation period, etc. This it could properly do. *Penn Mutual Life Insurance Co.* v. *Lederer*, 252 U. S. 523; *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109.

III

THE FAIR MARKET PRICE OR VALUE OF THE RESPONDENT'S DEFERRED DIVIDEND POLICIES ON MARCH 1, 1913, WAS NOT IN EXCESS OF THEIR THEN CASH SURRENDER VALUE OF $74,600

Even if we assume that Section 202 (a) (1), and not Section 213 (b) (2), of the Revenue Act of 1918, *supra*, is controlling in determining the net taxable income realized by respondent on the surrender of his policies May 19, 1919, it would still be true that the Circuit Court of Appeals erred in determining their fair market price or value on March 1, 1913, for such value was not in excess of their then cash surrender value, $74,600. (R. 74, 76.)

The aggregate sum provisionally ascertained and held by the company awaiting apportionment on May 19, 1919, was on March 1, 1913, $13,600. (R. 76.) If respondent had surrendered his policies to the company on March 1, 1913, he would have received their then cash surrender value of $74,600, and he would have received all that the contracts provided that he should receive. (R. 78.)

It is clear that there were no dividends or earnings of the company which have been credited to respondent in such a way that he could have realized them on the surrender of his policies on March 1, 1913.

New York Life Insurance Co. v. *Edwards*, 271 U. S. 109.

Respondent's contracts provided that the company would on May 19, 1919, provided the insured was then living, apportion to said contracts a share in the earnings and surplus of the company, but not otherwise. On March 1, 1913, respondent's interest in the aggregate amounts provisionally ascertained and held awaiting apportionment was wholly contingent, and on his death prior to May 19, 1919, the surplus and earnings of the company would have been payable, not to him or to his beneficiaries, but to the surviving members of his class.

Not only was the share of respondent in the company's earnings and surplus wholly contingent on March 1, 1913, so far as he himself was concerned, but his "share of the forfeiture" in the redundancy of the premiums of other policy-holders of his class who did not survive or who did not persist in premium payments to the end of the tontine period was likewise not determinable on that date. *Penn Mutual Life Insurance Co.* v. *Lederer*, 252 U. S. 523, 532.

Certainly Congress in enacting the Revenue Act of 1918 could not have contemplated that the March 1, 1913, basis of establishing gain or loss and the computation of taxes imposed by that Act could in any wise be made dependent upon purely speculative and contingent future events.

As was said by the Board of Tax Appeals in the *Appeal of E. A. Armstrong*, 1 B. T. A. 296, 298:

> The Revenue Act of 1918 does not contemplate the computation of gain or loss by reference to contingent values. • • • The capital value so recoverable must be a market value, a realizable value—not a theoretical value computed by reference to some future contingent event.
>
> • • • • •
>
> The capital value at March 1, 1913, which the taxpayer is entitled to have returned before he can be said to have had taxable profit will be the cash surrender value of the policy at that date plus any accumulated dividends or excess premiums which had been credited to him in such a way that he could have realized them had he surrendered the policy on March 1, 1913. Any greater value would be purely speculative and contingent, and can not be made the basis for computing taxes.

IV

THE DEPARTMENTAL CONSTRUCTION OF THE STATUTE

Section 213 (b) (2) of the Revenue Act of 1918, *supra*, was a reenactment by Congress of the provisions of Section 4 of the Revenue Act of 1916, c. 463, 39 Stat. 756, 758. This section was again reenacted without change as Section 213 (b) (2) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 238, and again as Section 213 (b) (2) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 268.

The language of Section 213 (b) (2) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 24, is somewhat changed, but in effect reenacts the provisions of the prior Acts and excludes from gross income—

> Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. * * *

This language was carried into Sec. 22 (b) (2) of the Revenue Act of 1928, Act of May 29, 1928.

Article 5 of Regulations 33 (Revised), promulgated January 2, 1918, is identical in substance with Article 72 (b) of Regulations 45 (1920 Edition), and the latter was carried forward into Article 72 (b) of Regulations 62, pertaining to the Revenue Act of 1921, and again into Article 72 of Regulations 65, pertaining to the Revenue Act of 1924. These regulations and the practice thereunder have now been in force for more than ten years.

Subsequent to the promulgation by the Treasury Department of Regulations 33 (Revised), January 2, 1918, under the Revenue Act of September 8, 1916, Congress passed the Revenue Act of 1918, the Revenue Act of 1921, the Revenue Act of 1924, the Revenue Act of 1926, and the Revenue Act of 1928. None of these Acts, however, questioned the con-

struction and action of the Commissioner of Internal Revenue relative to the imposition of taxes on the surrender by the policyholder of life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract. The rule applies that when Congress reenacts a statute without change it is deemed to have adopted the practice of the Department in its interpretation and application of the statute. *National Lead Co.* v. *United States*, 252 U. S. 140, 145–146.

CONCLUSION

In view of the far-reaching effect of the opinion below and the manifest importance of an authoritative rule for the guidance of the Treasury Department in the administration of the tax statutes, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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SEPTEMBER, 1928.

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In the Supreme Court of the United States

OCTOBER TERM, 1928

No. 481

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE for the District of Kentucky, petitioner

v.

A. J. A. ALEXANDER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the District Court of the United States for the Western District of Kentucky (R. 28-33) is reported in 21 F. (2d) 68. The opinion of the Circuit Court of Appeals for the Sixth Circuit (R. 70) is reported in 27 F. (2d) 237.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Sixth Circuit was entered on June 30, 1928. (R. 69.) Petition for certiorari was filed Septem-

ber 28, 1928. Certiorari was granted November 19, 1928. (R. 75.) Jurisdiction is conferred upon this Court by Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Deferred dividend policies were issued to a taxpayer in 1899. The policies, which were fully paid up in 1908, matured in 1919. They provided that no dividend should be apportioned until maturity and then only if the insured were living. At maturity the taxpayer surrendered the policies and in addition to their face value received aggregate dividends of $20,797. Upon these facts, the question is whether in computing the taxable gain under Section 202 (a) (1) of the Revenue Act of 1918, the March 1, 1913, value should be restricted to the amount then realizable upon the policies, or whether the speculative future value to the insured if he held the policies, discounted to 1913, was the proper basis.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1065:

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> (1) In the case of property acquired before March 1, 1913, the fair market price

or value of such property as of that date;
* * *.

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, * * *;

(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * *

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

* * * * *

Regulations 45 (1920 Edition), Art. 87, p. 53:

ART. 87. *Income accruing prior to March 1, 1913.*—Property held by the taxpayer on March 1, 1913, is capital. * * * In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a

basis for the purpose of ascertaining the gain derived from the sale or other disposition of such policy. * * *

STATEMENT

Two policies of life insurance were issued to respondent by the New York Life Insurance Company on June 5, 1899, effective May 19, 1899. The face value of each policy was $50,000. Each was described as "insurance bond with guaranteed interest" and contained provisions for participating in deferred dividends and surplus. The policies were fully paid up on March 19, 1908, after ten premium payments aggregating $78,100 had been made. Each policy contained the following provisions as to deferred dividends and surplus (R. 34):

ACCUMULATION GUARANTEES

This insurance bond participates in surplus as hereinafter provided, but no dividend shall be apportioned to it before the end of the accumulation period. If the insured elects to continue this insurance bond beyond the accumulation period under one of the two accumulation benefits first named below, no further dividend shall be apportioned to it before the end of each period of five years thereafter.

The accumulation period of this insurance bond ends on the nineteenth day of May in the year nineteen hundred and nineteen. If the insured is living and if the premiums have been duly paid to that date, and not

> otherwise, the company will then apportion a dividend to the insured, who shall have the option of continuing or discontinuing this insurance bond under one of the following four accumulation benefits: * * *.

Respondent being alive at the maturity of his policies on May 19, 1919, elected to receive the cash surrender value of the policies and received the sum of $120,797. (R. 35.) In making his income-tax return for the year 1919, respondent showed thereon, among things as income, dividends on insurance policies in the sum of $17,290.35. (R. 34.)

Upon reaudit of the said return, the Commissioner found the amount of income realized by respondent upon the surrender of the said insurance policies to be the sum of $42,697 or the difference between the cash surrender value, $120,797, and the total premiums paid, $78,100. An additional assessment in the amount of $11,334.17 resulted, of which respondent paid $8,750.91 (R. 35) and brought this suit for its recovery.

On March 1, 1913, the loan value of each of the policies was $37,300 (R. 30), a total of $74,600. It is conceded that the loan value was the equivalent of the cash surrender value (R. 30).

The District Court determined the March 1, 1913, value of these policies as follows:

The policies being fully paid up, the insurance company had provisionally set aside certain sums as the accumulation on these policies which, on March 1, 1913, amounted to $13,600. Assuming

that the same rate of accumulation would continue, it appeared at that time that this amount would grow by May 19, 1919, to the sum of $19,428.57, which, added to the face value of the policies, would make a total estimated value of $119,428.57. The present value of this sum on March 1, 1913, at 4 per cent per annum compounded annually was found to be $93,587.81, and this sum deducted from the amount actually received, $120,797, gave $27,209.19 as the taxable gain. (R. 32–33.) Judgment was rendered for the respondent on this basis. (R. 33.) This calculation resulted in a judgment for the respondent in the sum of $6,519.36. (R. 33.) This was less than the sum sued for, $8,750.91. (R. 27.) The collector brought error and the respondent cross error (R. 70) and the case was taken to the Circuit Court of Appeals for the Sixth Circuit.

That court affirmed the judgment of the District Court, and sustained the method under which it determined the March 1, 1913, market price or value of said policies as $93,587.81. (R. 73.) Certiorari was granted by this Court to review the decision of the Circuit Court of Appeals for the Sixth Circuit.

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred in holding that the taxable gain realized by the respondent, upon surrender by him at maturity of the two insurance policies involved in this case, was only $27,209.19; and in failing to hold, under the provisions of Sections 213 (b) (2) and 202 (a) (1),

Revenue Act of 1918, *supra*, that the taxable gain realized by the respondent was the difference between the sum paid by the insurance company, $120,797, and the total of premiums paid, $78,100, without interest, or $42,697.

SUMMARY OF ARGUMENT

On March 1, 1913, the only realizable value of the insurance policies was the cash surrender value. Cash surrender value has always been used as an index of the value of life insurance policies. The Bankruptcy Act permits a bankrupt to pay the amount of the surrender value to the trustee in redemption of his insurance policy. It was the purpose of the Bankruptcy Act to give the full value of the policy to creditors and the cash surrender value was specified as the equivalent of the full value. If it is the full value for the purpose of administering the Bankruptcy Act, there is no reason why any greater value should be adopted under the Revenue Acts. The Revenue Act of 1918 does not contemplate the computation of gain or loss by reference to contingent and speculative values which may later accrue. Accordingly, the basis for determining gain or loss under Section 202 (a) (1) of the Revenue Act of 1918 would be the cash surrender value of these policies on March 1, 1913, in the amount of $74,600. However, in view of the provision of Section 213 (b) (2) of the statute, the gain in this case was computed upon the basis of the total amount of premiums paid, $78,100.

ARGUMENT

THE VALUE OF A LIFE INSURANCE POLICY ON MARCH 1, 1913, SHOULD BE RESTRICTED TO ITS REALIZABLE VALUE DISREGARDING ALL SPECULATIVE OR CONTINGENT VALUES WHICH MAY LATER ACCRUE

The problem in this case is to determine the gain derived by respondent upon the disposition of property acquired before March 1, 1913. Section 202 (a) (1) of the Revenue Act of 1918 specifically provides that the basis for such determination is the fair market price or value of such property as of that date. The property here consisted of policies of insurance which were not salable. Therefore, the basis in the case at bar must be the fair market value as of March 1, 1913. In computing that value petitioner contends that it must be restricted to the realizable value.

The only realizable value of these policies on March 1, 1913, was the cash-surrender value. The policies contained no schedules of cash-surrender value. However, they did contain schedules of loan values which, it is conceded, had the same effect as cash-surrender value. (R. 30.) In any event a cash-surrender value exists whether or not recognized by the policy. *Richter* v. *Rockhold* (C. C. A. 5th), 253 Fed. 941. Cash-surrender values have always been used as an index of the value of life insurance policies. *Hiscock* v. *Mertens*, 205 U. S. 202, 212; *Appeal of E. A. Armstrong*, 1 B. T. A. 296. Aside from that they could not be said to have any appreciable value. *In re Newland*, 18 Fed. Cas. 90.

Article 87 of Regulations 45 (1920 edition) provides:

> In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for the purpose of ascertaining the gain derived from the sale or other disposition of such policy.

Similar language is contained in all of the subsequent regulations. (Article 90, Regulations 62; Article 90, Regulations 65; Article 90, Regulations 69.)

Section 70 (a) of the Bankruptcy Act (Act of July 1, 1898, c. 541, 30 Stat. 544, 565) recognizes no other value and permits the bankrupt to retain his policy free from the claims of creditors upon payment to the trustee of the amount of the cash surrender value.

In *Burlingham* v. *Crouse*, 228 U. S. 459, the full amount of the surrender value had been loaned by the company and the Court held that "the speculative right to the net proceeds of the policies" did not pass to the trustee. This Court further said:

> (p. 472.) Congress recognized also that many policies at the time of bankruptcy might have a very considerable present value which a bankrupt could realize by surrendering his policy to the company.
>
> * * * * *
>
> (p. 473.) We think it was the purpose of Congress to pass to the trustee that sum which was available to the bankrupt at the time of bankruptcy as a cash asset, * * *.

The purpose of this provision of the Bankruptcy Act was thus construed in *Frederick* v. *Fidelity Ins. Co.*, 256 U. S. 395, 397:

> This provision shows it was the purpose of Congress to pass to the trustee whatever sum was available to the bankrupt at the time of bankruptcy as cash assets to be realized on surrender of the policy, but otherwise to leave to the insured the benefit of his life insurance.

A similar construction was given in *In re Gannon* (C. C. A. 2d), 247 Fed. 932, 936, where it was said:

> The theory of the law is that the creditors of a bankrupt are entitled to everything that a bankrupt could get out of the policy by his own act at the time he was put into bankruptcy.

From these decisions we think it is clear that the Bankruptcy Act has recognized that the cash-surrender value is the full value of an unmatured insurance policy. The principle was firmly established when the Revenue Act was adopted and there is no reason why its value for tax purposes should be any greater.

The total loan value or cash-surrender value on March 1, 1913, was $74,600. (R. 31.) The premium payments on the policies were completed on March 19, 1908, and amounted to $78,100. (R. 34.) The policies were surrendered on May 19, 1919, and the company paid the respondent $120,797. (R.

35.) Except for the provisions of Section 213 (b) (2), the cash-surrender value, $74,600, would be the proper basis for determining gain or loss. However, since the statute provides that the amount received by the insured as a return of premiums shall not be included in gross income, the Commissioner computed the income realized by respondent upon the surrender of his policies to be the difference between the $120,797 actually received and the total premiums paid, $78,100. (R. 35.) Since this resulted in a smaller taxable income than would have followed from computing the gain upon the March 1, 1913, value, $74,600, no constitutional question arises.

The accumulation period under the policies ended on May 19, 1919. The policies provided that if the insured were alive on that date and the premiums had been duly paid, but not otherwise, the company would then apportion a dividend to the insured. (R. 34.) During the accumulation period the company provisionally ascertained the amounts attributable to these policies, but whether respondent would ever actually receive them depended upon his survival to the end of the accumulation period. On March 1, 1913, the total amount thus provisionally ascertained was $13,600. (R. 31.) In view of the policy provision, the insurance company was not required to and, as a matter of fact, had not, irrevocably set aside to these policies any part of the accumulations which would ultimately go to them if the insured lived out the accumulation period.

The accumulation period had not expired on March 1, 1913, and the provisional accumulations were not available to respondent upon that date. Accordingly, it is submitted that the only demonstrable value of these policies on March 1, 1913, and the only realizable value at that time, was the cash-surrender value of $74,600. To assign any larger value to the policies on March 1, 1913, it is necessary to determine present value for speculative and contingent rights which may later accrue.

It was more advantageous to the respondent to keep the policies at that time than it would have been to realize on them, but the Revenue Act does not contemplate the computation of gain or loss by reference to contingent values. Respondent's choice of a medium of investment was his own. Because he preferred to invest in property which had no sale on March 1, 1913, is no reason why a theoretical value computed by reference to some future contingent event should be adopted. The statute contemplates a realizable value, which in this case is demonstrated to have been the cash surrender value. By virtue of Section 213 (b) (2) respondent has not been restricted even to that, but has been given the benefit of the total premiums paid.

The District Court disregarded the realizable value and took into account the benefits which the taxpayer might reasonably anticipate receiving if he continued to hold the policies instead of realizing on them on March 1, 1913. Assuming that the rate

of accumulation would be maintained, it was determined that by the end of the accumulation period a dividend of $19,428.57 would be available. This depended, of course, upon the respondent living out the accumulation period, but considering his age and his expectancy of life the court found that on March 1, 1913, respondent could have reasonably anticipated receiving on May 19, 1919, the face amount of the policies, $100,000, and $19,428.57 in accumulations, or a total of $119,428.57. By the application of a four per cent interest rate, compounded annually, the present value of that sum on March 1, 1913, was calculated to be $93,587.81. This amount was treated as the fair value of the policies on March 1, 1913. By taking the difference between it and the $120,797 actually received upon the surrender of the policies, the court arrived at a taxable gain of $27,209.19.

This method of calculation was plainly erroneous. The policies had a definite, realizable value on March 1, 1913. Whether they would ever be worth more to respondent depended upon a contingency. No part of the subsequent increase in the cash surrender value can be regarded as an item in the value of the policies on March 1, 1913. Neither could the dividends which were provisionally apportioned on March 1, 1913, nor those which were apportioned later, be regarded as items entering into the March 1, 1913, value. At that time the respondent had absolutely no interest in such dividends. That was

settled by this Court in *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109, where the policies in question were like those involved in the instant case.

Not only was the share of the respondent in the company's earnings and surplus wholly contingent on March 1, 1913, but his "share of the forfeitures" was likewise contingent upon the redundancy in premium of other policyholders who might not persist in premium payments to the end of the contract period. *Penn Mutual Co.* v. *Lederer*, 252 U. S. 523, 532.

It is plain that the District Court indulged in speculation when it calculated the March 1, 1913, value of property in which the respondent had absolutely no interest on that date. The later value which accrued to these policies did not exist on March 1, 1913, and it is submitted that there is no reason or logic in applying a formula to determine the present value of something which does not exist. On March 1, 1913, the only realizable value was the cash-surrender value and the calculation of the present value of other property which accrued later is not contemplated by the statute.

The March 1, 1913, value of a life-insurance policy was involved in the *Appeal of E. A. Armstrong*, *supra*. The taxpayer in that case urged that the policy was then worth more than the cash-surrender value. However, the Board of Tax Appeals held that no theoretical or contingent values could enter

into the calculation. The Board said (pp. 297–298):

> • • • The taxpayer contended in argument that the policy was really worth a lot more than its surrender value on March 1, 1913, because other members of the tontine group had dropped out, etc., and that every time one dropped out the value of the policies of the remaining members increased; but such increased value was entirely contingent upon the taxpayer's remaining in the group until the maturity of his policy. The market or realizable value of the policy was not changed by the occasional elimination of members of the group, though the probable time of maturity may have been advanced—remaining, however, strictly contingent.
>
> The Revenue Act of 1918 does not contemplate the computation of gain or loss by reference to contingent values. A taxpayer who owned an asset before March 1, 1913, and disposed of it thereafter is entitled in computing profit to subtract from the selling price the capital value which he held on March 1, 1913 (or the cost to him, if higher), plus any additional cost incurred after March 1, 1913, with proper adjustments for values recovered through depreciation, etc. The capital value so recoverable must be a market value, a realizable value—not a theoretical value computed by reference to some future contingent event.
>
> • • • • •
>
> The capital value at March 1, 1913, which the taxpayer is entitled to have returned be-

> fore he can be said to have had taxable profit will be the cash surrender value of the policy at that date plus any accumulated dividends or excess premiums which had been credited to him in such a way that he could have realized them had he surrendered the policy on March 1, 1913. Any greater value would be purely speculative and contingent, and can not be made the basis for computing taxes.

In thus restricting the March 1, 1913, value of an insurance policy to the value definitely realizable upon that date, it is submitted that the Board of Tax Appeals applied the correct principle. There is no precedent for any other basis of valuing an insurance policy.

The Circuit Court of Appeals sustained the basis of determining the March 1, 1913, value which had been adopted by the District Court upon the theory that if the policies had been salable their market value would have been not less than the amount computed by the District Court, $93,587.81. Of course, if the nature of the property had been different and there had been a ready market for it, a different result would be reached. Since they were not salable, the Circuit Court of Appeals decided that the policies were worth that much to the insured. In so proceeding, we submit that the court lost sight of the fact that the statute contemplates no other basis than realizable value. There is no latitude for indulging in speculation with regard to what property is worth to an owner who does not

sell. The only market for these policies was the insurance company which issued them and the full amount which could have been received by the respondent on March 1, 1913, was the cash surrender value, $74,600.

The Circuit Court of Appeals has considered the word "value" as used in the statute as opposed to fair market price and given it the meaning of "value to the owner." This is clearly erroneous. The statute comprehends fair market price or fair market value. The later statutes employ the term "fair market value" alone. (See Section 204 (b), Revenue Act of 1924, c. 234, 43 Stat. 253, 259, U. S. C., Title 26, Sec. 935; Section 204 (b), Revenue Act of 1926, c. 27, 44 Stat. 9, 16, U. S. C. App., Title 26, Sec. 935; Section 113 (b), Revenue Act of 1928, c. 852, 45 Stat. 791, 821.)

The method adopted by the court in valuing the contract involved in *Kentucky Tobacco Products Co.* v. *Lucas*, 5 F. (2d) 723, establishes no precedent for the method of valuing the life-insurance policies in the instant case. On March 1, 1913, the company in that case had an unexpired contract which enabled it to purchase tobacco stems at $8.51 per ton. The evidence showed a community of interest between the parties which accounted for the favorable contract price. About that time the company had been offered as much as $35 per ton for a limited quantity of the stems it was receiving under the contract and it was shown that $23.38

per ton was a fair value for such stems for the unexpired period covered by the contract.

While the court in that case applied a formula to determine the March 1, 1913, value of future speculative earnings, the facts in the case showed that the company practically controlled the supply of stems through its favorable contract and that at the expiration of the contract it could not profitably continue its business. Thus the speculative elements were reduced to a practical certainty and the case is *sui generis* and does not establish any precedent. Particularly is this true when dealing with a life-insurance contract. "While life insurance is property, it is peculiar property," *Burlingham* v. *Crouse*, 228 U. S. 459, 472, and we submit that the principle limiting the value of a life-insurance policy to its cash-surrender value is too well settled to permit a greater value to be assigned to such property for tax purposes.

CONCLUSION

For the reasons stated, we respectfully submit that the judgment of the court below should be reversed.

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Assistant Attorney General.
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FEBRUARY, 1929.

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In the Supreme Court of the United States

OCTOBER TERM, 1928

No. 481

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE for the District of Kentucky, petitioner

v.

A. J. A. ALEXANDER

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

STATEMENT

The brief for respondent contends that the proceeds of the life insurance policies in this case did not constitute income within the meaning of the Sixteenth Amendment. This question was not dealt with in the brief for the petitioner and this reply brief will be confined to that point.

ARGUMENT

THE AMOUNT REALIZED UPON THE SURRENDER OF LIFE INSURANCE POLICIES BY THE RESPONDENT IS TAXABLE INCOME TO THE EXTENT THAT IT EXCEEDS COST

Respondent seeks to inject into this case the question of whether the proceeds of insurance poli-

cies received by an insured where all premiums were paid prior to March 1, 1913, is taxable income. At the outset he is met by the settled rule that upon certiorari the only question which will be considered by this Court is the ground upon which the petition for the writ of certiorari was based. *Commercial Credit Co.* v. *United States*, 276 U. S. 226, 229. Respondent filed no petition for a writ of certiorari and a party who has not sought review is not entitled to review the part of the judgment of which he complains. *Fed. Trade Com.* v. *Pac. Paper Assn.*, 273 U. S. 52, 66.

However, should this Court find any persuasive reason for considering that question, we submit that when, as in this case, insurance policies matured during the life of the insured and the proceeds are paid to him, the gain upon such disposition of the property is true income within the meaning of that term as defined by this Court. That definition is "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets." *Eisner* v. *Macomber*, 252 U. S. 189, 207; *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S. 509, 518.

The policies were fully paid up in this case before March 1, 1913, the aggregate premiums amounting to $78,100. The Commissioner determined that the March 1, 1913, value was no greater. At maturity respondent received in 1919 from the company upon surrender of the policies the sum of $120,797. The

difference between these two amounts was treated as taxable income. In *Penn Mutual Co.* v. *Lederer*, 252 U. S. 523, this Court considered the nature of certain sums paid to policyholders by an insurance company and said (p. 532):

> But after the policy is paid up, the element of investment predominates and Congress might reasonably regard the dividend substantially as profit on the investment.

And in speaking of a policy holder who, like respondent, received a "share of the forfeiture" it was said (pp. 532–533):

> * * * the dividend represents in part what clearly could not be regarded as a repayment of excess premium of the policyholder receiving the dividend. For the "share of the forfeiture" which he receives is the share of the redundancy in premium of other policyholders who did not persist in premium payments to the end of the contract period.

It is evident that respondent's sole investment in the policies was the total premiums paid and that when he received a greater sum upon the surrender of the policies such excess was gain upon the investment or income. "The premium is in the nature of a savings deposit," *Penn Mutual Co.* v. *Lederer*, *supra* (p. 531), and the amount returned in excess of the premiums paid is of the same nature as interest paid by the savings bank.

Respondent relies upon *Gray* v. *Darlington*, 15 Wall. 63, and contends that all that can be taxed

in any annual period is the gain earned and realized in that period. It is true that under earlier Acts only annual income was taxed but that is no longer the practice. Because the language of the Act then under consideration was different in material particulars from that of the more recent statutes, *Gray* v. *Darlington, supra,* is no longer valuable as a precedent upon that point. *Hays* v. *Gauley Mt. Coal Co.,* 247 U. S. 189.

Respondent contends that the money received from the insurance company is a substitute for something which has been lost and assumes that the amount of the premiums could have been invested in securities yielding a higher rate of interest which would have returned on the maturity date of the policies a larger amount than was received from the insurance company. This is not a case of the receipt of proceeds of an insurance policy by a beneficiary. The respondent was the insured and did not receive the proceeds as a replacement of the value of a life. Therefore, the loss to which respondent refers must be the loss of interest upon the amount paid in as premiums. This Court has already decided that, for the purpose of determining net gain or loss in the purchase and sale of stock, interest is not a part of the cost of the assets. *Hays* v. *Gauley Mt. Coal Co., supra.* It was there said (pp. 192–193):

> That the sale resulted in a gain or profit to the extent of $210,000, the difference between the buying and selling prices, is not

> to be doubted, for there is no merit in the contention that interest should be added to the purchase price in order to ascertain its cost. The money that went into the purchase was not loaned at interest; on the contrary, by the very fact of the purchase it was placed where it could not earn interest for the respondent in the ordinary sense, and the gain represented by the increase of selling price over cost price must be regarded as a substitute for whatever return some other form of investment might have yielded.

In the instant case, the insurance protection received during all of the period the policies were in force is an additional substitute for the return some other form of investment might have yielded.

The question of interest was again considered in *Walsh* v. *Brewster*, 255 U. S. 536, 538, which involved bonds purchased in 1902 and 1903 and sold in 1916. The purchaser received no interest until 1906 and contended that interest upon the investment for the time which so elapsed should be added as a part of the cost to him of the bonds. That contention was rejected by this Court upon the authority of *Hays* v. *Gauley Mt. Coal Co., supra.*

It is clear from those decisions that lost interest is not an element to be taken into account in determining gain or loss upon the disposition of property, and we think the principle is equally applicable in determining the gain or loss upon the surrender of life insurance policies by the insured, the result being that all gain over cost is income

within the meaning of the Sixteenth Amendment and within the definition of the term which has been adopted by this Court.

CONCLUSION

In view of the foregoing, it is respectfully submitted that, while the question is not properly presented for the consideration of this Court, yet, in any event, the difference between the premiums paid by the insured and the amount received at maturity by the insured is properly taxed as income.

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MARCH, 1929.

○

In the Supreme Court of the United States

OCTOBER TERM, 1928.

No. 481

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF KENTUCKY, PETITIONER

v.

A. J. ALEXANDER.

BRIEF FOR RESPONDENT

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In the Supreme Court of the United States

OCTOBER TERM, 1928.

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF KENTUCKY, PETITIONER,

v.

A. J. A. ALEXANDER.

BRIEF FOR RESPONDENT

The petitioner bases his right to the writ on the following grounds: First, that the Circuit Court of Appeals decided an important question in Federal taxation which has not been heretofore decided by this court; second, that the Circuit Court did not apply Section 213-B of the Revenue Act of 1918 to the case under consideration, when in fact it was applicable; third, that the decision of the Circuit Court of Appeals is in conflict with the *Penn Mutual Life Insurance Company* vs. *Lederer*, 252 U. S. 523; *New York Life Insurance Company* vs. *Edwards*, 271 U. S. 109; fourth, that the decision of the Circuit Court of Appeals is in conflict with the rulings of the Board of Tax Appeals in the appeals of E. A. Armstrong, 1 B. T. A. 296; Appeal of Cline, 3 B. T. A. 1138; *Chamansky* vs. *Commissioner*, 8 B. T. A. 1276; fifth that the case is of great public interest and importance to the government in the administration of the Revenue laws.

(Page 6 of Petition).

(1) The respondent in 1899 was insured in the New York Life Insurance Company, a mutual company, doing business on the level premium plan, under two policies, identical in terms, of the face value of $50,000.00 each.

(R. 16-30).

The premium on the policies aggregated $7,810.00 annually and were to be paid for a period of ten years at which time the policies became fully paid up. The premiums were paid and on March 19, 1908, the respondent had paid all that he would ever be called upon to pay under the contracts. At the end of the twentieth year, the policies matured and the petitioner had various options to be exercised under the terms of the contract. On May 19, 1919, at maturity, the respondent elected to accept the benefits of Option 4 (R. 30), and received the entire cash value which was $120,797.00.

(R. 55).

The insurance contracts had no cash surrender value but did have certain loan values all of which are set out on page 29 of the Record. The petitioner, in making his income tax return for the taxable year 1919, reported a profit growing out of the surrender of the policies of $17,290.35 (R. 9). The Commissioner of Internal Revenue reaudited his tax return and found the profit on the surrender of the policies to be $42,697.00 which was the difference between the total amount received, to wit, $120,797.00 and $78,100.00, the sum paid in premiums.

(R. 55).

The respondent paid additional taxes found to be due by the Commissioner and, after complying with the formal provisions of the refunding statutes, instituted suit to recover the taxes thus paid. Judge Dawson of the district court at Louisville, in finding the March 1, 1913, value of the policies, said:

> "Under all the circumstances, I think it is fair to both the Government and the plaintiff to fix the value of what the plaintiff could at that date have reasonably anticipated they would have been worth on the 19th day of May, 1919, under the fourth option heretofore referred to, arriving at the then present value by the application of a four per cent interest rate, compounded annually. As I have heretofore indicated, I think the plaintiff on March 1, 1913,

> could reasonably have anticipated that at the end of the accumulation period he would receive at least $19,428.57 of accumulations, and in addition thereto the face value of the policies, or a total of $119,-428.57. The present value of this sum on March 1, 1913, at four per cent interest, compounded annually would be $93,587.81. This amount, I think, should be treated as the fair value of the plaintiff's two policy contracts on March 1, 1913. Deducting this sum from $120,797.00, the amount actually received by the plaintiff upon surrender of his policies at the end of the accumulation period, would result in a taxable gain of $27,209.19. Of this sum $20,797.00 was paid out of earned surplus, and is therefore taxable as dividends, which $6,412.19 thereof would be subject to both normal and surtax."
>
> (R. 43-44).

The Circuit Court of Appeals for the Sixth Circuit affirmed the judgment of Judge Dawson.

The Court of Appeals of Kentucky, in the case of the *Equitable Life Assurance Society* vs. *Winn*, 137 Ky. 649; 126 S. W. 153; 28 L. R. A. 558, in discussing the relationship existing between an insurance company and a policy holder, under the contracts similar to that of the respondent, said:

> "The insurer undertakes to handle the fund for the parties. Its pay is in the costs and expenses which it charges as toll. The balance not only belongs equitably to those contributing to it, according to the terms of their contracts, but the insurance company agrees to so apportion it among them. Now, why should it not keep its contract? To keep it faithfully, and honestly, it is required to keep books of account. Otherwise its apportionment would be a mere guess, even if it rose to that dignity. It is a trustee, an agent of those for whom it has essayed to act. It will not be heard to say that it would be too troublesome to keep the accounts, or would cost

too much to render the parties a true statement, or on that account be impracticable to show to a court of chancery in a suit for accounting the state of the books."

The case does not present an important question of Federal taxation not heretofore decided by the courts. The sole question is valuing contracts March 1, 1913, and similar questions have often been before the Courts and the Board of Tax Appeals. However, the specific question of valuing an insurance policy has not been decided.

Insurance contracts have all the elements of other contracts and stand on the same footing. It is true that such contracts cannot be traded in because of the lack of insurable interest but the respondent owned the two policies March 1, 1913, and there was a reasonable expectation that he would live to maturity of the contracts in 1919. It was as easy to value these contracts March 1, 1913, as it was the contract in the case of *Kentucky Tobacco Products Company* vs *Lucas*, 5 Fed (2d) 723 which the Court did.

To adopt the valuation made by the Commissioner of Internal Revenue works a hardship and a discrimination to taxpayers receiving the face of insurance policies where all the premiums were paid prior to March 1, 1913. The respondent had paid all the premiums on the policies in 1909 five years before the income tax law became effective and to decide that there was no increase in the value of the policies before March 1, 1913, is manifestly contrary to all the fundamental principles of life insurance. Such a contract gradually appreciates in value to the insured. The sum available for distribution on maturity increases as the life lengthens.

The respondent could reasonably expect on March 1, 1913, a return of $120,000.00 at maturity based on the known facts March 1, 1913.

(2) The point is urged that the Circuit Court did not apply or construe section 213 (b) (2), Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065. This is not true. Section 213 is

set out in full on page 3 of the printed copy of the Circuit Court's Opinion and it applies and construes that section in reaching its conclusion as the March 1, 1913, value of the policy.

No matter what the language of the Revenue Act under consideration may be it can have no application to a gain which had become capital March 1, 1913, *Doyle* vs. *Mitchell Bros.*, 247 U. S. 179.

Subsection 2 of the Revenue Act of 1918 does provide:

> "The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract."

This section of the Statute must be construed together with Subsection 1 of Section 202 which provides,

> "In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date."

Under the very language of the law, the only gain taxable is the accruing income after March, 1913. This was fully considered by the Circuit Court.

(3) The decision of the Circuit Court of Appeals is not in conflict with *Penn Mutual Life Insurance* vs. *Lederer*, 252 U. S. 523, and *New York Life Insurance Co.*, vs. *Edwards*, 271 U. S. 109.

These two cases involve the tax liability of the insurance companies and not the value of the policies of the insured. Both companies sought to deduct from income dividends provisionally ascertained but not paid or allocated to the particular policies. The Court decided this could not be done.

The respondent did not have a fixed liability against the insurance company on March 1, 1913, but he did have an insurance contract susceptible to a fair money value and he could, with reasonable expectation, determine what the policies would produce in 1919 at maturity. It will thus be seen that the two cited cases have no application to the case under consideration.

(4) The decision of the Circuit Court of Appeals is not contrary to the rulings of the United States Board of Tax Appeals in the Appeal of E. A. Armstrong, 1 B. T. A. 296; Appeal of Kline, 3 B. T. A. 1138; and *Chamansky* vs. *Commissioner*, 8 B. T. A. 1276.

In the Armstrong case the taxpayer had in 1901 taken out a policy in the Union Central Life Insurance Company for $10,000.00 face value with annual premiums of $478.40 for fifteen years. The policy had certain tontine features which were not disclosed in the statement of facts. The policy had no maturity date and it was impossible for the taxpayer to determine March 1, 1913, that he would realize anything from it at all. Its surplus accumulation depended, not on earnings of the company, but on lapses or death of members of the group. It has no similarity to the case here.

The appeal of Kline, 3 B. T. A. 1138, is distinguished from the case at bar in the opinion of the Circuit Court and has no question similar to this one.

In the case of *Chamansky* vs. *Commissioner*, 8 B. T. A. 1276, the question was whether the sum received on settlement of the policy was taxable as dividends or as ordinary income. There is no similarity between it and the case here.

(5) The point is seriously urged that this case is one of great public interest and importance to the Government. We earnestly contend that this is not true. As heretofore pointed out, it is a simple question involving the market value of a contract and if it is of importance, a casual exami-

nation of the record clearly indicates that the decision of the Circuit Court is correct.

Conclusion

We respectfully submit that the petition for the writ of *certiorari* to review the judgment of the Circuit Court of Appeals, Sixth Circuit, should be denied.

Beckham, Hamilton & Beckham,

George V. Triplett, Jr.,

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FILED
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CHARLES ELMORE C

IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 481.

ROBERT H. LUCAS, Collector of Internal Revenue for the District of Kentucky, - - - - - Petitioner,

vs.

A. J. A. ALEXANDER, - - - - - - Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 481.

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF KENTUCKY, - - - - - - - *Petitioner,*

vs.

A. J. A. ALEXANDER, - - - - - *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 481.

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF KENTUCKY, - - - - - - - *Petitioner,*

vs.

A. J. A. ALEXANDER, - - - - - *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF FOR RESPONDENT.

I.

STATEMENT OF CASE.

The above case comes to this Court on petition for *certiorari* to the United States Circuit Court of Appeals for the Sixth Circuit. The petition was filed September 28, 1928, and granted November 19, 1928 (R., p. 75).

The opinion of the lower court is found in the case of Lucas v. Alexander, Nos. 4973, 4974, and reported in 27 Fed. (2d) 237, and in the record, pages 70 to 74.

The action was filed in the District Court at Louisville, Kentucky, by A. J. A. Alexander, the respondent, against the petitioner, Robert H. Lucas, Collector of Internal Revenue for the District of Kentucky, seeking to recover income taxes, which the respondent claims were erroneously collected from him by the petitioner for the calendar year 1919 in the sum of $8,750.91 (R., p. 27).

The case was tried by Judge Chas. I. Dawson, District Judge for the Western District of Kentucky, on the law and facts, a jury being expressly waived (R., pp. 33-38). Judge Dawson rendered a written opinion in the case on March 9, 1927 (R., p. 28), and on the same date separated the findings of law and fact and a judgment was entered for the respondent in the sum of $6,519.36, together with interest and cost (R., p. 33).

The petitioner appealed by writ of error from the decision of the District Court to the United States Circuit Court of Appeals for the Sixth Circuit, which Court affirmed the judgment of the District Court June 30, 1928 (R., p. 70).

II.

STATEMENT OF FACTS.

The lower Court found the facts to be as follows:

> "First. Plaintiff is a citizen of Kentucky and resides at Spring Station, in the eastern district of Kentucky.
>
> "Second. Defendant is a resident of Louisville, Kentucky and since the 24th day of May, 1921, has

been the duly appointed, acting, and qualified collector of internal revenue for the district of Kentucky.

"Third. Plaintiff, before March 15, 1920, duly filed with the then collector of internal revenue for the district of Kentucky his income tax return for the calendar year 1919 and showed thereon, among things as income, dividends on insurance policies in the sum of $17,290.35, and a total net income of $65,690.21, and thereafter duly paid voluntarily and without protest to the then collector of internal revenue taxes assessed thereon in the sum of $13,135.52.

"Fourth. Plaintiff, on the 5th day of June, 1899, upon his application, was granted by the New York Life Insurance Company of New York City, New York, effective May 19, 1899, two policies of life insurance, each in the sum of $50,000.00 and each on the face thereof described as 'insurance bond with guaranteed interest.' Plaintiff agreed to pay on each policy in advance premiums at the rate of $3,905.00 per annum for a period of ten years, and his premium payments on said policies in the total sum of $78,100.00 were completed on March 19, 1908.

"Said New York Life Insurance Company is a mutual life insurance company doing business on the mutual-level premium plan.

"Fifth. Each of said policies contained the following provisions as to deferred dividends and surplus:

"'ACCUMULATION GUARANTEES.

"'This insurance bond participates in surplus as hereinafter provided, but no dividends shall be

apportioned to it before the end of the accumulation period. If the insured elects to continue this insurance bond beyond the accumulation period under one of the two accumulation benefits first named below, no further dividend shall be apportioned to it before the end of each period of five years thereafter.

"'The accumulation period of this insurance bond ends on the nineteenth day of May in the year nineteen hundred and nineteen. If the insured is living and if the premiums have been duly paid to that date, and not otherwise, the company will then apportion a dividend to the insured, who shall have the option of continuing or discontinuing this insurance bond under one of the following four accumulation benefits:

"'(1) Receive an income of two thousand dollars and ——— cents per annum during life (being equal to four percent of the initial amount of the insurance, $50,000), the first payment to be made on the nineteenth day of May, nineteen hundred and twenty, and receive the dividend converted into a life annuity payable with the income as above, and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

"'(2) Receive the dividend, in cash, and receive an income for life, payable as specified in the "first benefit," and continue this insurance bond without further payment of premiums (evidence of good health will not be required); or,

"'(3) Receive the entire cash value, as stated below, converted into an annual income during the life of the insured, payable as provided in the "first benefit" which income the company guarantees

shall be not less than thirty-four hundred and seventy-four dollars and ——— cents, and discontinue this insurance bond; or,

" '(4) Receive the entire cash value, as stated below, in cash, and discontinue this insurance bond.

" 'The company guarantees that the entire cash value of this insurance bond at the end of the accumulation period shall be fifty thousand dollars, and in addition the cash dividend then apportioned by the company.

" 'At the end of the accumulation period the company will send the insured a written statement, setting forth the results under each of the above accumulation benefits, and if the insured shall fail at that time to notify the company which benefit has been selected, the first benefit shall be considered selected.'

"Sixth. Each of said policies matured on the 19th day of May, 1919, and plaintiff elected to receive from the company, in accordance with the provisions of said option #4, the cash surrender value thereof, to-wit, $120,797.00, and subsequently said company on the surrender to it of said policies of insurance paid to said plaintiff in the calendar year 1919 cash to the amount of said $120,797.00.

"Seventh. On reaudit of plaintiff's income-tax return for said calendar year 1919 the Commissioner of Internal Revenue determined and found the amount of income realized by plaintiff on the surrender of his said policies to be the sum of $42,697.00 or the difference between the cash surrender value thereof, $120,797.00, and the total premiums paid by plaintiff, $78,100.00, and after making certain adjustments not material here duly assessed

an additional tax for said calendar year 1919 of $11,334.17 against said plaintiff.

"Eighth. Plaintiff, prior to bringing this action against the defendant on May 27th, had not paid the amount of said additional taxes assessed against him by said Commissioner of Internal Revenue, but had paid to said defendant only a portion thereof, to wit, the sum of $8,750.91, as follows:

"On November 2, 1923, plaintiff paid to defendant the sum of $8,013.54 under written protest and later, on December 5, 1923, the further sum of $737.37, making a total payment by said plaintiff to said defendant of said sum of $8,750.91, and no more, on said additional assessment of $11,-334.17.

"Ninth. Plaintiff, on December 5, 1923, filed with defendant certain claims for credit for alleged overpayment of income taxes for the calendar years 1918, 1920, 1921 and 1922, in the sums of $1,072.41, $434.97, $424.21, and $651.67, respectively, claiming total credits on account thereof in the sum of $2,583.26 as against said additional assessment of $11,334.17 for said calendar year 1919, and that said credit claims were duly transmitted to the collector of internal revenue, but no action thereon has been as yet taken by said Commissioner of Internal Revenue.

"Tenth. Subsequent to the assessment of said additional tax of $11,334.17 against said plaintiff by said Commissioner of Internal Revenue, said plaintiff filed with this defendant a purported claim in abatement and claim for refund in the sums of $3,320.63 and $4,894.39, respectively, to which was attached an amended return executed

by said plaintiff for said calendar year 1919, which showed, among other things, 'income from insurance policy' of $21,900.00, a total net taxable income of $70,621.39, and a total tax, according to plaintiff's computation of $16,132.20.

"Eleventh. Said purported claim for abatement and claim for refund was not transmitted by the defendant to the Commissioner of Internal Revenue at Washington, D. C., but said defendant notified said plaintiff by letter dated October 31, 1923, as follows:

"October 31, 1923.

JJB/ES
IT-2
Mr. A. J. A. Alexander,

Care Beckham, Hamilton & Beckham,
Inter-Southern Building, Louisville, Kentucky.

"Sir: This office is in receipt of your letter of the 26th instant enclosing check for $8,013.54 to apply on assessment of additional income tax for the year 1919; also a claim in abatement for $3,320.63 covering the remainder of the assessment.

"I regret to advise that this additional assessment is made by the Commissioner of Internal Revenue in accordance with section 250 (d) of the revenue act of 1921, which prohibits the collector from accepting a claim in abatement. It is therefore necessary to ask that payment of the full amount of $11,334.17 be made, and after the full payment is received the claim will be allowed to operate as a refund claim. Under the law there is no other course for this office to pursue, and I trust

that you will forward remittance for $3,320.63 by return mail.

Respectfully,

Robt. H. Lucas, Collector.

By Chief, Income Tax Division.

"Twelfth. After plaintiff filed said credit claims for said years 1918, 1920, 1921 and 1922, referred to in paragraph ninth hereof, plaintiff, on March 13, 1924, filed with this defendant's claim for refund in the sum of $18,755.87, which defendant duly transmitted to the Commissioner of Internal Revenue at Washington, D. C., but said Commissioner of Internal Revenue had taken no action thereon on or prior to May 27, 1924.

"Thirteenth. Said plaintiff, in filing his original return for said calendar year 1919, had failed to claim a deduction for depreciation on certain real estate in which he had an interest in the city of Chicago; and said Commissioner of Internal Revenue, on consideration of plaintiff's claim for refund of March 13, 1924, allowed a portion of the depreciation, and on October —, 1925, on account thereof, duly issued to said plaintiff a certificate of overassessment for said calendar year 1919 in the sum of $2,319.99.

"Fourteenth. That the correct income of the plaintiff for the year 1919 is as follows:

Gross income:		
Income from farming		$61,216.48
Deductions:		
Labor	$7,195.42	
Material supplies	12,154.87	
Merchandise bought for resale	32,972.40	
General expense	2,075.75	
Inventory beginning of year	36,980.00	
	$91,378.44	
Less inventory at end of year	59,365.00	
	$32,013.44	
Other deductions:		
Salaries	$3,612.78	
Rent	24.00	
Interest	780.67	
Taxes	1,860.00	
Repairs	656.50	
		$38,947.39
		$22,269.09
Other income:		
Salaries		2,000.00
Income from rent	$45,842.51	
Deductions:		
Repairs, wear and tear	$2,417.95	
Interest	4,583.33	
Taxes	4,543.15	
Other expenses	7,312.41	18,856.84
Income from rents		26,985.67
Trust income		5,200.00
Income from insurance policies		6,412.19

Dividends on insurance policies		20,797.00
Interest on bonds, foreign country		163.79
Ordinary dividends		4,337.11
		$88,164.85
Other deductions:		
Interest	$1,065.00	
Taxes paid	237.67	
Contributions	13,029.32	
		14,331.99
		$73,832.26

"Fifteenth. That the income tax to be determined on the above income is as follows:

Net income		$73,832.86	
Deductions:			
Dividends	$25,134.11		
Exemptions	1,400.00		
		26,534.11	
		$47,298.75	
Taxable at 4%		4,000.00	$160.00
Taxable at 8%		$43,289.75	3,463.90
Surtax			11,743.17
Total tax			$15,367.07

"Sixteenth. That the plaintiff paid to the collector of internal revenue on income shown on his original return, taxes in the following amounts:

Feb. 28, 1920	$3,283.88	
June 14, 1920	3,283.88	
Sept. 15, 1920	3,283.88	
Dec. 4, 1920	3,283.88	
		$13,135.52

"Seventeenth. That the plaintiff paid to the Collector of Internal Revenue on an additional assessment of taxes for 1919 in the amount of $11,334.17 the following amounts:

Nov. 2, 1923	$8,013.54	
Dec. 5, 1923	737.37	
		$8,750.91

"Eighteenth. That the defendant, Robert H. Lucas, collector of internal revenue for the district of Kentucky, erroneously collected from the plaintiff, on Nov. 2, 1923, but with probable cause $6,519.36, income taxes for the calendar year 1919.

"Nineteenth. That the court finds the March 1, 1913, value of the two insurance policies to be $93,587.81, which sum deducted from the amount received by the plaintiff on the surrender of the policy, to wit, $127,797.00, leaves a taxable gain of $27,209.19. Of this sum, $20,797.00 was paid out of earned surplus, and therefore taxable as dividends, and the balance of $6,412.19 subject to both normal and surtax" (R., pp. 34-38).

III.

QUESTIONS FOR DECISION.

What taxable gain, if any, was realized by the respondent under the provisions of Sections 213 (b) (2) and 202 (a) (2) of the Revenue Act of 1918, upon surrender by him, at maturity, May 19, 1919, of two participating, deferred dividend policies issued to him on May 19, 1899?

IV.

THE LAW.

THE CONSTITUTION:
Sixteenth Amendment:

"The Congress shall have power to lay and collect taxes on income from whatever source derived without apportionment."

THE STATUTES:
Section 202 of the Revenue Act of 1918:

"(a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal or mixed, the basis shall be—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

"(2) In the case of property acquired on or after that date, (a) the cost thereof; or (b) the inventory value, if the inventory is made in accordance with section 203. * * *" (40 Stat. L. 1060).

Section 213 of the Revenue Act of 1918:

"Gross income defined. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States and

all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; but

"(b) Does not include the following items, which shall be exempt from taxation under this title:

"(1) The proceeds of life insurance policies paid upon the death of the insured to individual beneficiaries or to the estate of the insured;

"(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment, or annuity contracts, either during the terms or at the maturity of the term mentioned in the contract or upon surrender of the contract; * * *" (40 Stat. L. 1065).

Section 210 of the Revenue Act of 1918:

"That in lieu of the taxes imposed by subdivision (a) of Section 1 of the Revenue Act of 1916,

and by Section 1 of Revenue Act of 1917, there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax, at the following rates:

"(a) For the calendar year 1918, 12 percentum of the amount of the net income in excess of the credits provided in section 216; provided, that in the case of a citizen or a resident of the United States the rate upon the first $4,000.00 of such excess amount shall be 6 percentum;

"(b) For each calendar year thereafter, 8 percentum of the amount of the net income in excess of the credits provided in Section 216; provided that in the case of a citizen or resident of the United States the rate upon the first $4,000.00 of such excess amount shall be 4 percentum."

THE REGULATIONS:
Articles 71 and 72 of Regulations 45:

"What excluded from gross income.—Gross income excludes the items of income specifically exempted by the statute and also certain other kinds of income by statute or fundamental law free from tax. Such tax-free income should not be included in the return of income and need not be mentioned in the return, unless information regarding it is specifically called for, as in the case, for example, of interest on municipal bonds. See article 402. The exclusion of such income should not be confused with the reduction of taxable income by the application of allowable deductions. See section 212 of the statute and article 21. As to exclusions from gross income by corporations, see section 233 and article 541.

"Proceeds of insurance.—(a) Upon the death of an insured the proceeds of his life insurance policies, whether paid to his estate or to individual beneficiaries (including partnerships), directly or in trust, are excluded from the gross income of the beneficiary. See article 541.

"(b) During his life only so much of the amount received by an insured under life, endowment or annuity contracts as represents a return, without interest, or premiums paid by him therefor is excluded from his gross income. See article 47.

"(c) Whether he be alive or dead, the amounts received by an insured or his estate or other beneficiaries through accident or health insurance or under workmen's compensation acts as compensation for personal injuries or sickness are excluded from the gross income of the insured, his estate and other beneficiaries. Any damages recovered by suit or agreement on account of such injuries or sickness are similarly excluded from the gross income of the individual injured or sick, if living, or of his estate or other beneficiaries entitled to receive such damages, if dead. See further article 294. Since June 25, 1918, no assessment of any Federal tax may be made on any allotments, family allowances, compensations, or death or disability insurance payable under the War Risk Insurance Act of September 2, 1917, as amended, even though the benefit accrued before that date."

V.

QUESTIONS AT ISSUE.

First: Are the proceeds of an insurance policy received by an insured where all premiums are paid prior to March 1, 1913, taxable income?

Second: What was the March 1, 1913, value of the two insurance policies of the respondent cashed by him for $120,797.00 in 1919?

VI.

ARGUMENT AND BRIEF.

Plaintiff realized no taxable gain on the surrender by him in 1919 of the two insurance policies, because all premiums due on said policies were paid before 1909 and the sum realized by him grew out of a contract based on the length of a human life and was not susceptible to measurement in money and is not income under the Sixteenth Amendment.

Point I. Proceeds of Life Insurance Policies do not Constitute Income Under the Sixteenth Amendment.

The Sixteenth Amendment authorized the Congress to tax only income. Income does not mean the mere receipt of money. There must have been some accretion after March 1, 1913. Receipt of the proceeds of an insurance policy does not ordinarily result in gain as understood under the definition of "income."

The proceeds replace a loss occurring by reason of lapse of time but do not add to the wealth of the insured. If collected in his lifetime, the sum received cannot be used to replace the loss by the acquisition of similar property. Time has exacted its toll. The increased premium necessary to replace the insurance exceeds the apparent gain over premiums paid and sum received.

The Brittanica, under the heading "Insurance," in discussing its value, says:

> "The value of insurance cannot be measured by figures. No direct balance sheet of profit or loss can exhibit its utility. The insurance contract produces no wealth. It represents only expenditures. If a thousand men insure themselves against any contingency, then whether or not the dreaded event occurs to any, they will in the aggregate be poorer as the direct result by the exact cost of the machinery for effecting it.
>
> "The distribution of property is changed, its sum is not increased, but the results in the social economy, the substitute of reasonable foresight and confidence for apprehension and sense of hazard, the large elimination of chance from business and conduct have a supreme value. The direct contribution of insurance to civilization is made not in visible wealth, but in the intangible and immeasurable forces of character on which civilization itself is founded. It has done more than all gifts of impulsive charity, to foster a sense of human brotherhood and of common interest. It has done more than all repressive legislation to destroy the gambling spirit. It is impossible to conceive of our

> civilization in its full vigor and progressive power without insurance. This principle which unites the fundamental law of practical economy that he best serves humanity who best serves himself, with the golden rule of religion 'Bear ye one another's burdens.' "

The respondent received the policies May 19, 1899, and on May 19, 1908, he had paid $78,100.00, or his total premiums.

There is no presumption arising by inference or otherwise that all or any of the gain between premiums paid and the sum received was realized in 1919. Section 210 of the Revenue Act of 1918 provides for annual rest in determining taxable profit and all that can be taxed in any annual period is that realized in that period. If all or any part of the cash received was earned before March 1, 1913, that portion attributable to or prior to March 1, 1913, is not income.

The Act of March 2, 1867 (14 Stat. at L., pp. 477, 478, Sec. 13) provided for gains and profits for the year ending December 31st which is in substance the same provision as Section 210 of the Revenue Act of 1918. In the case of Gray, Collector, v. Darlington, 14 Wall. 63, 82 U. S. 68, 21 Law Edition, 46, Darlington sold Government bonds which he had owned over a period of years. The Commissioner sought to tax all the gain in the year of payment. In holding that the Commissioner was in error, this Court said:

> "The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the

amount of the advance. Mere advance in value in no sense constitutes the gains, profits or income specified by the statute. It constitutes and can be treated merely as increase of capital.

"The rule adopted by the officers of the revenue in the present case would justify them in treating as gains of one year the increase in the value of property extending through any number of years, through even the entire century. The actual advance in value of property over its cost may, in fact, reach its height years before its sale; the value of the property may, in truth, be less at the time of the sale than at any previous period in ten years, yet, if the amount received exceed the actual cost of the property, the excess is to be treated, according to their views, as gains of the owner for the year in which the sale takes place. We are satisfied that no such result was intended by the Statute."

In the case of the United States Life Insurance Company v. Spinks, 126 Ky. 417, the Court of Appeals of Kentucky, in describing life insurance, said:

"Life insurance is not a modern business invention although modernly many new features have been added to it, which may seem to be foreign to its original conception. But the main principle upon which it rests has not been changed. The plan is to collect from a class of selected persons, chosen with reference to their ages, health, occupations, and so forth, such a fixed sum as will, when kept safely invested at interest, pay to the estate of each of them when he dies, a certain sum of money, which was originally taken as the basis of

the collections. It has been found, and it is a fact that this can be done. The percentage of mortality of such persons is ascertainable in advance. From a long series of observations it is known to a reasonable certainty how many of the number will die within a given time. Thus the life tables, or tables of mortality, have been made up. The one in most common, if not universal use in this country, is the American Experience. From these it is shown that of a given number of such persons of the same age and condition, each contributes a certain sum, either in one lump sum in advance, or in annual installments, that such contribution when loaned or invested at current interest compounded will so increase that as each one of the contributing class dies there will be enough in the common fund to pay to his estate a principal sum previously taken as the basis of the charges which he has contributed. The sum which he is required to pay is called the premium. If 1,000 men, aged 20, enter into an agreement to pay each one as he dies $1, and to provide in advance a fund therefor, which will be sufficient, and no more than sufficient, to meet the undertaking, they find that from the tables of mortality so many will die the first year, so many the second year, and so on, so that enough will have to be paid in advance that out of it there can be paid the death claims of the per cent who will die each year, and leave enough which, placed at compound interest, will accumulate a fund sufficient to pay all the others as they die the agreed sum of $1."

In the case of the United States v. Supplee-Biddle Hardware Company, 265 U. S. 189, 4 A. F. T. R. 3990, the Supreme Court was asked to decide that the pro-

ceeds of life insurance paid on the death of a person was in fact capital and not income. It declined to pass on the question, but did say:

> "It is earnestly pressed upon us that proceeds of life insurance paid on the death of the insured are in fact capital and cannot be taxed as income under the Sixteenth Amendment. Eisner v. Macomber, 252 U. S. 189, 207, 40 Sup. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 20 R. 1570; Merchants' Loan & Trust Co. v. Smietanka, 255 U. S. 509, 518, 41 Sup. Ct. 386, 65 L. Ed. 751, 15 A. L. R. 1305. We are not required to meet this question. It is enough to sustain our construction of the act to say that proceeds of a life insurance policy paid on the death of the insured are not usually classed as income."

Life insurance is not a commercial commodity. It is not dealt in on any stock exchange or traded in any market. It cannot pass freely between buyer and seller. Those who may contract concerning it are so limited in number it could never have a market value.

Under the laws of Kentucky one must have an insurable interest in another before he can acquire by purchase an interest in the insurance on his life.

The Court of Appeals of Kentucky in the case of Hess, Administrator, versus Segenfelter, 127 Ky. 348; 105 S. W. 476, in discussing the necessity of insurable interest before insurance could be collected, said:

> "On the other hand, what is known as 'wagering or gambling insurance' is universally con-

demned, and our court, in harmony with the doctrine generally prevailing, is strongly committed to the principle that a person cannot himself procure insurance upon a life in which he has not an insurable interest, growing out of a kinship, dependency, or the relation of debtor and creditor, nor obtain an assignment of such insurance; nor will a person be permitted to insure his own life for the benefit of another, if that other induces him to procure the insurance and pays the premiums thereon, or there is any evidence tending to show that the insurance was obtained with a view to avoid or evade the law against speculative insurance. Griffin's Adm'r v. Equitable Assurance Society, 84 S. W. 1164, 27 Ky. Law Rep. 313; Bromley v. Washington Life Ins. Co., 92 S. W. 17, 28 Ky Law Rep. 1300, 5 L. R. A. (N. S.) 747; Beard v. Sharp, 100 Ky. 606, 38 S. W. 1057, 18 Ky. L. R. 1029; New York Life Ins. Co. v. Brown, 66 S. W. 613, 23 Ky. Law Rep. 2070; Baldwin v. Haydon, 70 S. W. 300, 24 Ky. Law Rep. 900; Wrather v. Stacey, 82 S. W. 420, 26 Ky. Law Rep. 683; Lee v. Mutual Life Insurance Company, 82 S. W. 258, 26 Law Rep. 577; Barbour v. Larue, 106 Ky. 546, 51 S. W. 5, 21 Ky. L. R. 94; Basye v. Adams, 81 Ky. 363, 5 Ky. L. R. 91; Lockett v. Lockett, 80 S. W. 1152, 26 Ky. Law Rep. 300; Scott v. Scott, 77 S. W. 1122, 25 Ky. Law Rep. 1356; Adams v. Reed, 38 S. W. 420, 18 Ky. Law Rep. 853, 35 L. R. A. 692; Bramblet v. Hargis, 94 S. W. 20, 29 Ky. Law Rep. 610. Such insurance has a tendency to create a desire to destroy the life of the insured to obtain the insurance, there being no tie of blood or kindred, or interest to wish its prolongation; and a person who procures for his benefit insurance upon the life of

another, when he is not connected with that life by ties of kindred or dependency, or interested in its continuance from business motives, may be actuated solely by a purpose to derive profit from its destruction, and be rewarded by wagering against the amount payable at his death the sums expected in premiums during his life."

The number who can be beneficially interested in a life insurance policy is so limited that it can scarcely be said to be income gained through the sale or conversion of capital assets, if cashed.

The benefits accruing always rest basically on a human life and independently can have no existence. The contributions to procure and the sums received for it are so personal in nature that whatever is received does not fall within the definition of "income" as used in the Sixteenth Amendment. It is uniformly held that compensation for personal injuries, alimony payments and similar items are not taxable income. Such personal rights are not susceptible of money appraisal. See Gould v. Gould, 245 U. S. 151 (an alimony case).

There is no provision in the Revenue Act of 1918 relating particularly to the profit arising from an insurance policy and if taxable at all, it must be under the general provisions of the law. None of the items referred to in Section 213 of the Revenue Act of 1918 (40 Stat. 1065), refer specifically to the proceeds of a life insurance policy. The conversion to cash of life insurance policies is always contingent on the occurrence of two events, either the insured living to a fixed period or dying sooner. No income can arise from it

as enumerated in the law. It deals with none of those things but only with human life. Because perchance, the insured lives to a fixed time and cashes in his policy does not change the fundamentals of the contract. It is a replacement, a substitute for something lost.

Point II. The Insurance Policies of the Respondent were Contracts Primarily for Protection and not Investment.

It has been sometimes urged that insurance policies similar to those cashed by the respondent are contracts of hazard and therefore void. In the case of Simmons v. New York Life Insurance Company, 45 N. Y. Supreme Court Reports, 38 Hun. 316, the Court construed a policy essentially the same as that of respondent's and decided it was not a gambling contract. The Court of Appeals of Illinois, in the case of Rothchild v. New York Life Insurance Company, 97 Ill. App. Ct. 556, also held that similar policies of the New York Life Insurance Company were not gaming contracts. While these policies had hazards common to all life insurance contracts, they were out of the field of chance and provided protection which is the primary purpose of all life insurance.

The policies issued to the respondent (R., p. 12), provided for the payment of $50,000.00 on each of them to the personal representative of the insured in case of his death during the first ten years of their existence. This sum was gradually increased each year and during

the life of the policies, according to the terms of each, the following sums were payable in case of death:

"Table of Amounts payable in event of death during the accumulation period. If premiums are paid in full to date of death.

"The amount payable to the insured, in event of death prior to May 19, 1919, as specified on the face of the Bond, will be as set forth in the following table:

Year	Amount Payable		
First to tenth, inclusive	$50,000.00		
Eleventh	$50,700	Sixteenth	$61,650
Twelfth	52,700	Seventeenth	64,150
Thirteenth	54,800	Eighteenth	66,700
Fourteenth	57,000	Nineteenth	69,350
Fifteenth	59,300	Twentieth	72,150

If death occurred during the twentieth year it will be noted from the above schedule that the estate of the decedent would have received $144,300.00. The policies had no surrender value but did have the following loan and paid up insurance provisions (R., p. 16):

At End of		Extended Insurance for $50,000 for the term specified below, with cash, if then living.								
		Paid up Loans	Insurance							
3rd	Year	7,950	$15,000	17	Years	0	Months	with	$4,100	Cash
4th	"	10,600	20,000	16	"	0	"	"	11,700	"
5th	"	13,500	25,000	15	"	0	"	"	19,300	"
6th	"	16,750	30,000	14	"	0	"	"	25,250	"
7th	"	20,350	35,000	13	"	0	"	"	31,050	"
8th	"	24,350	40,000	12	"	0	"	"	36,500	"
9th	"	28,600	45,000	11	"	0	"	"	41,850	"
10th	"	30,600								
11th	"	32,700								
12th	"	34,900								
13th	"	37,300								
14th	"	39,700								
15th	"	42,250								
16th	"	44,950								
17th	"	46,500								
18th	"	48,150								
19th	"	49,900								
20th	"	For special Advantages at end of Accumulation Period, See Accumulation Benefits Below.								

The policies did have accumulation guarantees subdivided into four accumulation benefits (R., p. 16), but these were only incidental to the main provisions of the policies which was indemnity to the respondent's estate for the loss of his life.

The New York Life Insurance Company was a Mutual company. Its savings were in excess interest earnings, savings on mortality and expense loadings. The premiums charged were based on the life expectancy of the person insured with such a rate of interest compounded thereon semi-annually as would create a sum at the end of the life sufficient to pay the face of the policy. The whole scheme was based on the life expectancy of every member insured in the Company.

The policies of the respondent provided for payment in the case of death in the year of the end of the accumulation period of $23,503.00 more than was paid on the surrender of the policies. This large discount clearly indicates that the two policies were not primarily for investment but were to protect respondent's estate against loss by reason of his death. The case of Penn. Mutual Life Insurance Company v. Lederer, 252 U. S. 523, relied on by petitioner, was a case involving the tax liability of the insurance company and not of the insured and while the language of that opinion indicates that the Court thought a savings bank and a life insurance company were somewhat analogous, it does not decide against the contentions of the respondent here. The insurance company is engaged in lending money, its income being primarily from interest but the

contract between the company and the policy holder is based on entirely different principles.

The point is made by petitioner that after May 19, 1908, the premiums having been fully paid the investment feature of the policies predominated and when the respondent in 1919, received the surrender value of the policies he collected his investment together with the profits thereon. This point is made on the reasoning of the Penn. Mutual case, but it is not applicable to this case.

The Court has judicial knowledge that whether the life insurance premium is payable in one lump sum or annually has nothing to do with the essential features of the contract as between the company and the insured. The company cannot expect any further sum from the insured, out of which to create a fund to pay the policies at maturity and of course its reserve additions to the particular policy must be created solely out of interest earnings or investments, savings on mortality or expense loadings. The respondent could have secured his protection by spreading his payments over a longer period, which would have added nothing to the essential features of the contract. The aggregate payments would have been more, but the interest earned less.

The Court also knows that the prevailing rate of interest on investments during the period of respondent's contracts was approximately four per cent.

If he had invested the $78,100.00 paid by him in premiums in securities yielding five per cent interest compounded annually he would have had returned to him on the maturity date of the policies $168,422.76

which would have been $47,625.76 more than he received out of the insurance. Assuming that the respondent was a man of reasonably good business acumen, we think this fairly shows that his purpose in effecting the insurance contract was to protect his estate against loss in the event of death and not for the purpose of investment.

Point III. Section 213 of the Revenue Act of 1918 does not Indicate that Congress Intended the Proceeds of Life Insurance Paid to the Insured to be Taxable Income.

Section 213 excludes from income the proceeds of life insurance paid to individual beneficiaries or to the estate of the insured.

Subsection 2 of that section also excludes return premiums received by the insured either during the term of the policy or at maturity. Under the subsection, if the Congress had intended to include the excess premium return as income, it could have so provided by the addition of a few words which it did not do. The very fact that the Congress wrote Section 213 and the subparagraphs in the language as appears is a strong indication that it did not intend the proceeds of insurance policies to be taxable under the Sixteenth Amendment, no matter by whom collected.

In writing every insurance policy it is essential that the company have some dependable information based on past experience to estimate the deaths likely to occur within the year in the group insured. This cannot be determined by the toss of a coin, the play of a card, the

roll of dice or the turn of a roulette wheel. It is likewise impossible to predict what particular individual will die within the year, but if the group is large enough and the ages known, we may determine with almost mathematical certainty how many will die within a given year. After this fact is ascertained the company must determine what sum will be required to meet the face of the policies at the expected maturity, which is always less than the face of the policies, because of the expected accretions by interest earnings, savings on mortality or expense loadings.

Because the company must guarantee the payment of the policy at maturity, the assumed interest rate is less than the prevailing rate, and if the deaths are less than expected and the interest earnings more than assumed, there is a saving in mortality. The savings in mortality do not constitute "income" as contemplated under the Sixteenth Amendment.

The Congress recognized the impossibility of separating the savings in mortality from interest earnings and expense loadings and for that reason sums received at the maturity of insurance policies, do not constitute taxable gain.

Funds saved from mortality experience in any year although available for surplus distribution do not constitute taxable income because such savings are not within the definition of income set out in the statute. All expense loadings not used during the year are also available for surplus distribution but these do not constitute taxable income.

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The legal reserve for petitioner's policies was four per cent. The company had available for surplus distribution excess interest earnings above the reserve rate. Dividends distributed from this source would be taxable if the interest was earned after March 1, 1913.

There was also available for surplus distribution sums derived from lapsed policies which had paid in premiums in excess of policy reserves and expense of writing. Funds from this source would not constitute taxable income. There was available for surplus distribution gain on the sale of capital assets if the company had such. Profit from this source would also constitute taxable income, if the gain was after March 1, 1913.

The method of determining surplus distribution to policyholders of the New York Life Insurance Company holding preferred dividend policies is stated in the case of Miller v. New York Life Insurance Company, 179 Ky. 246, 200 S. W. 484, in which the Court said:

> "The method of apportionment employed by the defendant when a class completes its period of accumulation, which method appears to have been followed in the case of plaintiff's policies, is: (1) To apply to each class, not the mortality experience of that class within itself, but the average mortality rate of the company's experience among all its deferred dividend policyholders; (2) to charge the policies of the class with their proportionate share of the company's expenses; (3) to credit the class with interest at the average rate earned by the company on all its funds; and (4) to apply the

average rate of lapse and surrender prevailing among all policies issued on that plan of insurance. Whenever a class completes its period of accumulation, the defendant company makes a calculation on the theory of its going into liquidation, and apportions to that class such part of the total assets of the company as it would receive if the company were on that date in fact going into liquidation. As to the particular class it is an actual liquidation. By this method, it is stated in the proof, all the assets of the company are apportioned, leaving no balance."

Point IV. Regulations of the Treasury Department do not have the Force and Effect of Law.

The petitioner relies on Article 72 B of Regulations 45 and Article 5 of Regulations 33, promulgated by the Treasury Department under the Revenue Acts of 1918 and 1917 respectively. Article 5 of Regulations 33 is a copy of the law. Article 72 B of Regulations 45 provides:

> "During his life only so much of the amount received by an insured under life endowment or annuity contracts as represents a return without interest of premiums paid by him therefor is excluded from his gross income."

A regulation promulgated by the Secretary of the Treasury cannot add to or take away a single word of the law or the Constitution nor can such a regulation be substituted for the law.

The income tax law has been in effect in the United States for comparatively few years and many questions

are now reaching the Courts for the first time. Most of the cases coming before the Bureau of Internal Revenue concerning life insurance have been those relating to dividends paid on policies and only three have been before the Department where a policyholder had gotten the policy before March 1, 1913, and had cashed it subsequently. For these reasons, the regulations issued by the Department should have but little weight.

The Commissioner of Internal Revenue cannot lift himself by his own boot straps. The writer had just as well cite his own opinion in support of his contentions as for the Internal Revenue Department to cite its own rulings in its support.

The Supreme Court in the case of Morrill, Collector, v. Jones, 106 U. S. 466, 3 A. F. T. R. 2448, in discussing the weight to be given Treasury regulations, said:

> "The Secretary of the Treasury cannot by his regulations alter or amend a revenue law, all he can do is to regulate the mode of proceeding to carry into effect what Congress has enacted."

In the case of the Grand Rapids and I. Railway Company v. Boyle, Collector, 245 Fed. 792, 1st A. F. T. R. 851, the Court said:

> "On the part of the defendant, there has been cited a Treasury decision. While that decision, which in fact is a rule promulgated for the guidance of revenue collectors of the government, is entitled to some consideration, it is not entitled to great weight, because to make it controlling would be permitting a party to a lawsuit to formu-

late and determine the rule of law by which his case should be decided. The party promulgating the rule contained in that Treasury decision is the real party defendant in this action, and, of course, courts cannot permit a party to a lawsuit to say what the rule of the law for the decision shall be."

See also the case of Greenport Basin & Construction Company v. United States, 269 Fed. Reporter, 58, 2nd A. F. T. R. 1289.

In the case of the United States v. Hurst, 2nd Fed. Rep. (2nd), page 73, 5th A. F. T. R. 5129, the Court said:

"Furthermore revenue statutes must be more strongly construed against the Government and in favor of the citizen in case of doubt. Gould v. Gould, 245 United States, 151."

Again, in the case of Baltzell v. Mitchell, 3rd Fed. Rep. (2nd) 428, 5 A. F. T. R. 5232, the Court said:

"The construction of a statute must be a rational and sensible one, having in mind its evident purpose and the intention of Congress, and if such a construction can be found it must prevail, even though in conflict with the dry words of the statute. Church of the Holy Trinity v. United States, 143 U. S. 457, 12 S. Ct. 511, 36 L. Ed. 226; United States v. Laws, 163 U. S. 258, 16 S. Ct. 998, 41 L. Ed. 151; Taylor v. United States, 207 U. S. 120, 28 S. Ct. 53, 52 L. Ed. 130."

In view of these cases the question here for decision must be approached with every presumption in favor of the taxpayer.

The petitioner relies on three decisions of the Board of Tax Appeals as sustaining his position that the sum received by the respondent in excess of the premiums paid constitutes taxable income.

First: Appeal of Armstrong, 1 B. T. A. 296.

Armstrong's policy was issued to him in 1901 and matured in 1920, and had certain tontine features. The Board decided that the March 1, 1913, value of the policy could not exceed the cash surrender value plus any accumulated dividend or excess premiums which had been credited to the policyholder in such a way he could have realized them had he surrendered the policy on March 1, 1913. The Armstrong policy had no provision postponing the payment of dividends or distribution of surplus. The only expression used in the Board's opinion which decides against the contention of the respondent is that the policyholder March 1, 1913, can take into consideration only those sums which he can obtain by surrender of the policy. The policy in this case had no maturity date, which depended on the withdrawal or death of the members of the group. We do not know what value the policyholder was claiming in excess of that allowed by the Board. In the opinion it is said:

> "The taxpayer has developed several involved theories of his taxability."

These theories are not disclosed. We find nothing in the opinion of value in deciding the instant case.

Second: Appeal of Kline, 3 B. T. A. 1138.

Kline had a policy in the New York Life Insurance Company which seems to be similar to those of the re-

spondent. All the premiums were paid prior to March 1, 1913. The terms of the policies are not set out. The Board states the facts and sustains the Commissioner on finding the March 1, 1913, value of the policy to be its cash surrender value. No opinion is written by the Board.

Third: Shamansky v. Commissioner, 8 B. T. A. 1276.

The only contention made by the taxpayer in the above case was whether the sum received in excess of premiums paid on an endowment policy was subject to surtax and normal tax or surtax only. Nothing was involved in the case similar to this one.

Point V. The Insurance Policies Surrendered by the Respondent in 1919 had a Value March 1, 1913, Greatly in Excess of the Premiums Paid.

On May 19, 1899, the respondent made application to the New York Life Insurance Company for the two insurance policies surrendered by him on May 19, 1919. The premium on each policy was to be paid in ten annual installments of $3,905.00, the total on both policies for all years being $78,100.00, all of which was paid before March 19, 1908. The Commissioner of Internal Revenue in determining the tax liability of the respondent found a gain in this transaction of $42,697.00, the difference between the premiums paid and the sum received on surrender and that all of this gain was realized by the respondent between March 1, 1913, and May 19, 1919. In other words the Commissioner found

on identically the same investment no gain for fourteen years and a gain of 35% plus in six years.

This conclusion is contrary to all principles of insurance financing and the gain as determined by the Commissioner shows his method of determining the profit was arbitrary and without sound basis.

It is a matter of common knowledge that insurance companies build up reserve to pay the face of policies at maturity and this is done by taking the premiums, when paid, and investing the sum at such a rate of interest as will accumulate a sufficient sum at the end of the expected life of the insured to pay the policy. At the time the respondent acquired his policies, Sections 88C, 69C, page 1969, Laws of New York, 1892, provided as follows:

> "Whenever any policy of life insurance issued after January 1st, 1880, by any domestic life insurance corporation, after being in force three full years, shall by its terms lapse or become forfeited for the non-payment of any premium or any note given for a premium or loan made in cash on such policy or security, or of any interest on such note or loan, the reserve on such policy computed according to the American Experience Table of Mortality at the rate of four and one-half per cent per annum shall, on demand made, with surrender of the policy within six months after such lapse or forfeiture, be taken as a single premium of life insurance at the published rates of the corporation at the time the policy was issued, and shall be applied, as shall have been agreed in the application or policy, either to continue the insurance of the policy

in force at its full amount, so long as such single premium will purchase temporary insurance for that amount, at the age of the insured at the time of lapse or forfeiture, or to purchase upon the same life at the same age paidup insurance, payable at the same time and under the same conditions, except as to payment of premiums as the original policy. If no such agreement be expressed in the application or policy, such single premium may be applied in either of the modes above specified at the option of the owner of the policy, notice of such option to be contained in the demand hereinbefore required to be made to prevent the forfeiture of the policy. The reserve hereinbefore specified shall include dividend additions calculated at the date of the failure to make any of the payments above described according to the American Experience Table of Mortality with interest at the rate of four and one-half per cent per annum, after deducting any indebtedness of the insured, on account of any annual or semi-annual or quarterly premium then due, and any loan made in cash on such policy, evidence of which is acknowledged by the insured in writing. The net value of the insurance given for such single premium under this section, computed by the standard of this State, shall in no case be less than two-thirds of the entire reserve, computed according to the rule prescribed in this section after deducting the indebtedness as specified, but such insurance shall not participate in the profits of the corporation. If the reserve upon any endowment policy, applied according to the provisions of this section as a single premium of temporary insurance be more than sufficient to continue the insurance to the end of the endowment

term named in the policy, and if the insured survive that term, the excess shall be paid in cash at the end of such term, on the conditions on which the original policy was issued. This section will not apply in any case where the provisions of the section are specifically waived in the application, and notice of such waiver is written or printed in red ink on the margin of the face of the policy when issued."

It will be noted under the above section that the reserve interest rate used in the State of New York was 4½%, compounded annually. It is also a matter of common knowledge that insurance companies fix the premium on the policy for a greater sum than will be needed at 4½%, compounded annually, to pay the policy at maturity. This is called "expense loading," which is used for the purpose of paying extraordinary claims arising from epidemics, pestilences, etc., also to pay what is usually called "overhead," such as office rents, officers' salaries, etc. Every life insurance policyholder carries his own insurance. If at any given age he should study the life tables and get his own expectancy and on that date invest a given sum of money yielding him 4½% compounded annually over a period of his expected life, then if he should live out his expectancy he would, at the end of his life, have accumulated a greater fund than that provided to be paid by a life insurance company, because he would save overhead expenses, the cost of writing the insurance which must be paid by all life insurance companies. No stock company could ever have enough capital to bear the weight

of the liability represented by the face of policies. It is as impossible for companies to dissipate their reserves in dividends to stockholders and survive as for a human to extend his life beyond the God-given span.

Even a superficial study of the subject is bound to convince anyone that the premium paid must be kept intact and have added to it each year interest compounded annually at at least 4½% to take care of the policy at maturity. The respondent paid his first premium of $7,810.00 on May 19, 1899. All of this sum was probably consumed in the expense of writing the insurance, made up of agent's commission, medical examination and other expenses incident thereto. All of the premiums were paid by May 19, 1908, and long before that time a part of this sum commenced to yield 4½% compounded annually. According to Mr. Bowerman, Actuary for the Company (R., p. 56), the two policies had a maturity reserve of $114,000.00 March 1, 1913. In addition to the policy reserve requirements, it is generally known that the interest yield was in excess of 4% or 4½% for all years prior to March 1, 1913. The insurance company had this source of income in excess of the policy reserve. It is also well known that expenses and losses incident to the operation of an insurance company cannot be known in advance and the premium is usually fixed at a greater sum to cover these contingencies than past experience would indicate as necessary. Excess interest earnings, savings in mortality and savings in expenses create what is usually referred to as the surplus earnings of an insurance company.

If it is a stock company, this surplus is available for distribution as dividends; if a mutual company, as is the New York Life Insurance Company, the sum is available for distribution to the policyholders.

Commencing as early as 1860 there was a widespread agitation in some of the eastern States for an investigation of insurance companies as to the methods of handling surplus earnings created from lapsed policies, excess interest earnings, savings in mortality and expense loadings. Up to that time and for a considerable period thereafter the funds contributed by the financially weak who were compelled to lapse their insurance went to the financially strong which resulted in large sums being distributed to those who had in no way contributed to produce them. These investigations, and exposures growing out of them, finally caused the enactment of laws in Massachusetts and New York providing against the forfeiture of funds paid to purchase life insurance. Other States, along with Kentucky, rapidly followed the lead of the eastern States so that by 1899 practically every State in the Union required insurance companies, in the case of lapsing policies, to use the reserves created to provide the insured with a paid-up insurance. Many of the States, including the State of New York, have adopted so-called annual "dividend statutes" requiring the yearly distribution of surplus among policyholders contributing to it. These provisions of the law are also found in the Kentucky Statutes, Sections 652 and 659. The Kentucky law is also made applicable to foreign insurance com-

panies doing business in the State. See Mutual Benefit Life Insurance Company v. O'Brien, 116 S. W. 750.

The Statutory law, of course, is a part of every insurance contract and under this law the respondent had set aside to him the reserve which his premiums bought and surplus earnings or policy dividends. It could not be taken from him under any contingency. These accretions were as constant and fixed as statutory enactment could make them.

In the case of Simons v. New York Life Insurance Company, *supra*, the Court in discussing the surplus provisions of a policy similar to respondent's said:

> "So far as that contract of insurance is concerned there is no claim that the defendant has not fully complied with its undertaking. One part of every premium is set aside to accumulate as a fund toward the payment of the policy when it becomes a claim against the company. That fund is called the reserve fund. Another part of the premium is consumed in paying the costs of insurance and expenses. The remaining third part, augmented by the excess of interest earned upon the reserve of the policy, is surplus. Under an ordinary policy this surplus is annually returned to a policyholder in some way agreed on and is commonly called dividend.
>
> "On this policy has been engrafted the system called tontine, under which that surplus, instead of being divided and paid to the policyholder, goes to a fund called the tontine fund, the amount being credited to the particular class to which the policy

belongs. When a policy lapses the reserve value becomes profits, and under the scheme such profits are divided among the surviving holders of the various classes. Such in substance is the tontine scheme, and such it was represented to be by the pamphlet issued by the company and read in evidence on the trial of this action. *The annexation of the plan to the policy did not invade nor vary the legal effect of that instrument as a policy of insurance for life* (Italics ours). It merely constituted a consent for the retention of the surplus dividend by the company during the tontine period, at the termination of which the accumulations from all sources are to be divided among the surviving holders of policies of that class in existence. The representations complained of had reference only to the surplus dividends, left with the company by consent of the insured for accumulation during the tontine period."

Point VI. The Provisions of the Policies.

The policies of the respondent were not separable into distinct contracts and in valuing them March 1, 1913, we must consider each in its entirety. In addition to the provisions of the policies providing for the payment of fixed sums in case of death, each had accumulation guarantees (R., pp. 22-23). The first was the right to participate in the surplus of the Company during the entire life of the policies, the first allocation to be made May 19, 1919.

The second provision set out how the accumulations were to be distributed, in one of four ways at the option

of the assured. Under the first option, he could receive a life annuity of $4,000.00, his age at that time being forty-four years with a life expectancy of 25.71 years which would have made a total paid in annuities of $102,840.00 and in addition to this he could convert the accumulated dividends into a life annuity.

Under the second option he could receive the dividends in cash and an annuity of $4,000.00 for life.

Under the third option, he could receive a guaranteed life annuity of $6,948.00 which based on his life expectancy would make a total paid in annuities of $179,833.08.

Under the fourth option, he could receive the entire face of each policy plus accumulated dividends in cash which he did.

If he elected to accept none of the above accumulation benefits he was entitled to a paid-up life insurance policy of $114,000.00.

Point VII. Facts Indicating March 1, 1913 Value.

If on March 1, 1913, the respondent had sought to value his policies he could not have determined the valuation by resorting to any market, because from the nature of the contract, it could not be traded in, bought or sold. The method usually employed to determine the fair cash value of any other assets was absolutely barred. The only method that could have been employed was to ascertain what the New York Life Insurance Company had that would probably be available for distribution to him on the maturity date of the poli-

cies. According to the terms of the contract he was to receive $100,000.00 in cash and whatever cash dividends were available for distribution. According to the records of the Company the policies had earned no dividends the first two years. The third year $450.00 was earned and there was a rapid increase down to January 1, 1913, when earnings amounted to $12,500.00 (R., p. 52). The history of the Company clearly indicated that the earnings subsequent to 1913 would be greater than prior thereto. According to the books of the Company the respondent could reasonably have concluded that he would receive on the maturity date of his policies $118,269.24. The Company had thirteen years experience in dividend accretions to the policies and had averaged annually $961.54. The earnings showed a constant increase and he could reasonably have anticipated that they would be greater for the years subsequent to March, 1913, than prior. In view of the fact that life insurance can have no market value, we must resort to some other method of valuation. In such state of case its value to the owner is one way to test it. See McCarthy v. Blacknell, 162 S. W. 1163; also its intrinsic value may be considered. See Virginia v. West Virginia, 238 U. S. 202; Henry v. North American Railroad Construction Company, 158 Fed. 79; Crutchfield v. Julia, 147 Fed. 65. What a person uniformly earned from a newspaper route was held to be competent evidence in the case of Aeken v. Spreckles, 24 Cal. A. 251. On the question of the value of rose bushes, plaintiff was permitted to testify as to the number of roses raised

per bush and the value per blossom. Southwestern Portland Cement Company v. Kezer, 174 S. W. 661.

In Section 202 of the Revenue Act of 1918 is used the following language:

"fair market price or value."

These words are not interchangeable and where there is no fair market price March 1, 1913, we must of necessity resort to the fair value of the assets and in line with the authorities above cited we must find what was the fair value of the insurance policies to the plaintiff March 1, 1913. From his standpoint he had the right to value them from every angle. They were undoubtedly worth more than the premiums he had paid thereon. He had paid the full premium several years before that time and reserves had been built up, which would carry the insurance far beyond March 1, 1913. The policies provided for the payment of $109,600.00 on that date in case of death and $114,300.00 if death occurred in 1919. At the time of maturity he could convert them into a much larger sum with fully paid-up insurance for life. The experience of the company showed the expectations of much greater dividend earnings. Their intrinsic value to him was at least the face of the policies $100,000.00 plus surplus additions of $12,500.00 which would make a total value March 1, 1913 of $112,500.00 and would show a taxable gain of $8,297.00.

Judge Mack, in the Appellate Court's opinion, criticizes this statement as follows:

> "The attempt is made, by reasoning not entirely clear, to take the face of the policy plus the provisionally apportioned dividends as the value in 1913. If the theory of this is that plaintiff was sure to get at least that amount in 1919, there is the obvious objection that plaintiff has lost sight of the fact that a future accruing sum must be discounted to find its present value" (R., p. 74).

Judge Mack overlooked the certainty of future savings from March 1, 1913, to the date of the maturity of the policies, which would be sufficient to offset the discount used to find present worth.

Valuation is always a question of fact and does not yield to arbitrary calculations or to fixed rules of arithmetic. When considered in connection with the income tax law it should be fair and just to both the Government and taxpayer and no fact or circumstance should be overlooked which throws any light on the subject. To say, as was said by the Commissioner of Internal Revenue, that the plaintiff realized a profit on this transaction of $42,697.00 is simply ignoring the truth and violates every intendment of justice.

In the case of Doyle v. Mitchell Bros. Company, 247 U. S. 179, the Court was discussing gain realized from the sale of assets acquired before and sold subsequent to 1913, and in discussing this point said:

> "The formula that the entire receipts derived from a conversion of capital assets after deducting cost value must be treated as net income, so far as it is applied to a conversion of assets acquired before the act took effect, and so as to tax as income

any increased value that accrued before that date, finds no support in either the letter or the spirit of the act, and brings the former into incongruity with the latter. If the gross receipts upon such a conversion are to be treated as gross income, what authority have we for deducting either the cost or the previous market value of the assets converted in order to arrive at net income? The deductions specifically authorized are only such as expenses of maintenance and operation of the business and property, rentals, uncompensated losses, depreciation, interest and taxes. There is no express provision that even allows the merchant to deduct the cost of the goods he sells.

"Yet it is plain, we think, that by the true intent and meaning of the act the entire proceeds of a mere conversion of capital assets were not to be treated as income. Whatever difficulty there may be about a precise and scientific definition of 'income' it imports, as used here something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax: conveying rather the idea of gain or increase arising from corporate activities. As was said in Stratton Independence v. Howbert, 231 U. S. 399, 415, 58 L. Ed. 285, 292, 34 Sup. Ct. Rep. 136. 'Income may be defined as the gain derived from capital, from labor, or from both combined.'

"Understanding the term in this natural and obvious sense, it cannot be said that a conversion of capital assets invariably produces income. If sold at less than cost, it produces rather loss or outgo. Nevertheless, in many if not in most cases there results a gain that properly may be accounted as a part of the 'gross income' received 'from all

> sources' and by applying to this the authorized deductions we arrive at 'net income.' In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.
>
> "This has been recognized from the beginning by the administrative officers of the Government."

It will be noted in the above case that the court is thoroughly committed to the doctrine that there can be no taxable gain from the sale of capital assets or their conversion into cash until after the passage of the income tax law.

In the case of Lynch v. Turrish, reported in 247 U. S. 219, Turrish acquired in 1903 certain stock in a domestic corporation and in 1914 it sold its capital assets and distributed the proceeds to its stockholders. The corporation was the owner of large tracts of timber land, which had greatly increased in value due to a gradual rise in the market value of timber. Turrish received in the distribution twice the par value of his stock. The Commissioner of Internal Revenue assessed and collected taxes on all that Turrish received above par value on the ground that all the income had accrued to him after the income tax law became effective. The court, in deciding against the contention of the Commissioner, said:

> "The point in the case seems a short one. It, however, has provoked much discussion on not only the legal, but the economic distinction between

capital and income and by what processes and at what point of time the former produces or becomes the latter. And this in resolution of a statute which concerns the activities of men, and intended, it might be supposed, to be without perplexities and readily solvable by the offhand conceptions of those to whom it was addressed.

"The provisions of the act, so far as material to be noticed are the following: That there is assessed 'upon the entire net income arising or accruing from all sources in the preceding calendar year to every person residing in the United States, a tax of one per centum per annum upon such income.' * * *

"By paragraph B it is provided that, subject to certain exemptions and deductions, 'the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service, also from interest, rent, dividends, securities or the transaction of any lawful business carried on for gain or profit or gains or profits and income derived from any source whatever.'

"After specifying the exemptions and deductions allowed, the law declares as follows:

> 'The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first; Provided, however, that for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive.'

"It will be observed, therefore, that the statute levies a normal tax and an additional tax upon net incomes, derived from whatever source, 'arising or accruing' each preceding calendar year ending December 31, 1913, the tax shall be computed on the net income accruing from March 1, 1913, to December 31, 1913.

"And in determining the application of the statute, to Turrish, we must keep in mind that, on the admitted facts the distribution received by him from the Payette Company manifestly was a single and final dividend in liquidation of the entire assets and business of the company, a return to him of the value of his stock upon the surrender of his entire interest in the company, and at a price that represented its intrinsic value at and before March 1, 1913, when the act took effect.

"The district court and the circuit court of appeals decided that the amount so distributed to Turrish was not income within the meaning of the statute, basing the decision on two propositions, as expressed in the opinion of the circuit court of appeals, by Sanborn, Circuit Judge: (a) The amount was the realization of an investment made some years before, representing its gradual increase during those years, and which reached its height before the effective date of the law, that is, before March 1, 1913, and the mere change of form of the property 'as from real to personal property, or from stock to cash,' was not income to its holders because the value of the property was the same after as before the change; (b) the timber lands were the property, capital, and capital assets of their legal and equitable owner, and the enhancement of their value during a series of years prior

to the effective date of an income tax law, although divided or distributed by dividend or otherwise subsequent to that date does not become income, gains, or profits taxable under such an act.'

"For proposition (a) the court cited Collector v. Hubbard (Brainard v. Hubbard), 12 Wall. 1, 20 L. Ed. 272; Bailey v. New York, C. & H. R. R. Co., 22 Wall. 604, 22 L. Ed. 840, and the same case in 106 U. S. 109, 27 L. Ed. 81, 1 Sup. Ct. Rep. 62. For proposition "B" Gray v. Darlington, 15 Wall. 63 L. Ed. 45, was relied on.

"The government opposes both contentions by an elaborate argument containing definitions of capital and income drawn from legal and economic sources and given breadth to cover a number of other cases submitted with this. The argument, in effect, makes any increase of value of property income, emerging as such and taxable at the moment of realization by sale or some act of separation, as by dividend declared or by distribution, as in the instant case. * * *

"In Collector v. Hubbard, *supra*, the distinction between a corporation and its stockholders was recognized, and that the stockholder had no title for certain purposes to the earnings of the corporation, net or other, prior to a dividend being declared, but they might become capital by investment in permanent improvements and thereby increase the market value of the shares, 'whether held by the original subscribers or by assignees.' In other words, it was held that the investments of the corporation were the investments of the stockholders; that is, the stockholders could have an interest, taxable under the act considered, though not identical with the corporation. This was repeated in

Bailey v. New York, C. & H. R. R. Company, 22 Wall. 604, 635, 636, 22 L. Ed. 840, 848, 849.

"The latter case came here again in 106 U. S. 109, 27 L. Ed. 81, 1 Sup. Ct. Rep. 62, and it was then declared that the purpose of an income tax law was to tax the income for the year that it accrued; in other words, no tax in contemplation of the law accrues upon something except for the year in which that something, earnings, profits, gains, or income accrues. In that case the subject of the tax was a scrip dividend, but the certificates did not show the year of the earnings and testimony as to the particular year was admitted. The principle applies to the case at bar. If increase in value of the lands was income, it had its particular time, and such time must have been within the time of the law to be subject to the law; that is, it must have been after March 1, 1913, but, according to the fact admitted, there was no increase after that date, and therefore no increase subject to the law. There was continuity of value, not gain or increase. In the first proposition of the court of appeals we therefore concur." • • •

There was no fresh contribution by the respondent after 1909 to the capital of his investment on which the Commissioner assessed the gain. The sole question for the Court to decide is what was the actual increase in plaintiff's investment from March 1, 1913, to May 19, 1919, and without any new contribution to the capital thereof it would seem there could be no gain.

Our courts, in an effort to arrive at justice in the administration of the law, so far as value is concerned, have in some cases applied the straight-line theory of

appreciation from cost to sale price. This principle has been applied in the valuation of corporate stock when there was no provable market value. Such an apportionment must rest on some fair inference of fact. This method of valuation peculiarly appeals to our reason in determining the gain realized by the respondent in the surrender of his insurance policies.

The Court judicially knows the tremendous improvement in health conditions in the United States from the beginning of the present century. Progress in sanitation and advancement in medical science have lengthened the average span of human life.

There has been no material change in interest earnings and it may be safely assumed that the greatest source of dividend distribution to policyholders of insurance companies is by reason of reduced mortality. The available sums for distribution to policyholders in mutual insurance companies has been gradual over the life of the policies.

It is fair both to the Government and the insured to spread the deferred dividends over the period of apportionment. In the case of United States v. B. M. C. Copper and Silver Mining Co., 1 Fed. (2d) 31, 5 A. F. T. R. 5070, the Commissioner of Internal Revenue had applied the "straight line" theory of increase on the sale of the capital assets of a corporation. The Court held it did not apply in that case but stated when it would apply as follows:

> "Were evidence of actual value wholly impossible, warrant for the application of the rule might

be found in necessity. So, too, it might be that from slight or remote evidence, such as that during a period of years there was a gradual and apparently uniform development of surrounding conditions bearing upon the value of specific property, which physically remained unchanged, the difference between the selling price at the end of the period and the cost at the beginning could reasonably be distributed over the entire period, without specific evidence of value in any given year. But such apportionment would rest upon a fair inference of fact, while the rule here put forth by the government is of universal application, without any proofs whatsoever, or any justification in necessity, and rests upon a pure presumption. I am inclined to think the case is not appropriate for the recognition of such a presumption.

"For present purposes, however, let us accept the theory upon which the government has proceeded. Admittedly the presumption is rebuttable, and makes only a *prima facie* case, the ultimate strength of which depends upon the nature of the property and attendant conditions. To find for it any basis of reason at all we must assume that in common experience the rise and fall in value of property is generally gradual and approximately uniform, and is graphically represented by a straight line, and that fluctuations, represented by a curved or broken line, are exceptional. We are to bear in mind, too, that the ultimate inquiry here is not the average increase in value per year during the period from 1887 to 1910, but the actual increase from January 1, 1909, to April 1, 1910, and that this actual increase is the only legitimate basis upon which the tax can be assessed. Doyle v. Mitch-

ell Bros., 247 U. S. 179, 38 Sup. Ct. 467, 62 L. Ed. 1054; U. S. v. Cleveland, etc., 247 U. S. 195, 38 Sup. Ct. 472, 62 L. Ed. 1064. Hence if we accept the straight line method, it must be regarded as the means, of reaching, not a general average for the entire period, but the actual increase during the period in question."

Point VIII. The Insurance Policies are Kentucky Contracts.

The applications for these policies ~~was~~ were written in Kentucky; sent to the home office in New York, the policies written at the home office and mailed to the agent and delivered by him to the respondent in Woodford County, Kentucky (R., pp. 58-59). The Court of Appeals of Kentucky, in the case of Jefferson v. the New York Life Insurance Company, 151 Ky. 609, 152 S. W. 780, in deciding what law would govern the provisions of the policy of the New York Life Insurance Company made and delivered under the same facts as in the case at bar, said:

"When his first statement is read in connection with his amplified statement, it is apparent that the policy was forwarded by the home office to the agent at Lexington, under the rules and regulations governing them in the conduct of their business, and these rules required, as stated, that the agent was to deliver the policy only under specified conditions, and not otherwise. So that the question as to whether or not the policy should be delivered by the local agent could be determined only

when the attempted delivery was made. If there was then no material change in the health of the applicant, and the requirements of the company as to payment of the first premium complied with, he was authorized to deliver the policy, and not otherwise. Under these circumstances, the policy was not forwarded by the home office to the local agent to be delivered by him without conditions or limitation. It was a Kentucky contract; and the New York statutes, having no extraterritorial force or effect, cannot be considered in determining appellants' rights. These rights must be determined by the contract of insurance as expressed in the policy when read in the light of the Kentucky statutes."

In the case of Maddox v. Mutual Life Insurance Company, 193 Ky. 38, 234 S. W. 951, the Court of Appeals described an insurance policy similar to respondent's as follows:

"Dividend policies are of different classes; some of them allow, by agreement, a distribution of the dividend annually, and they are called annual dividend policies; while others defer the right to appropriate the dividend or surplus to an agreed period, some 5 years, some 10 years, some 15 years, and others 20 years, as was agreed in the policy sued on herein, and they are called 'deferred dividend policies.' In deferred dividend policies it is usually stipulated that the insured is not entitled to any part of the surplus, or dividend, until the expiration of his dividend period, whatever that may be, and if he dies, and his policy should be paid within that time, the accumulated surplus or divi-

> dends accumulated on his policy is lost, and goes to augment the dividend fund to be applied to other policies of that class, which survive the dividend period. The same result is sometimes true with reference to lapsed or surrendered policies, but that source of augmentation of the surplus has been largely curtailed in latter years by statutory provisions for paid-up insurance."

In the above decisions the Kentucky Court recognized the validity of contracts providing for the distribution of so-called surplus of insurance companies to policyholders, but refused to permit their application in advance of date of maturity of the policy to the purchase of paid-up insurance.

The petitioner relies upon the cases of the New York Life Insurance Company v. Miller and Jefferson v. New York Life Insurance Company, heretofore cited by us. The only question decided by these two cases was that provisionally ascertained dividends could not be applied to purchase paid-up insurance when the policies lapsed before maturity. We are not concerned with accrual of either income or deductions. The primary question is one of valuation which is essentially different from when income is received or when deductions may be taken.

Adam Smith in his "Wealth of Nations" assigns to the word "value" two different meanings, one expressing utility of some object and the other the power of purchasing goods which the possession of a particular object enables the possessor to do. One may be called the "value in use," the other the "value in exchange." The value in use is undoubtedly very valuable evidence

as to the market value or intrinsic worth. Any person purchasing property is chiefly concerned as to return in money or use. The best evidence of value of the insurance policies of the respondent as of March 1, 1913, was not what he could realize from them on that date, but what they would return to him in the future. In the case of Wells Fargo Company's Express v. Crawford County, 63 Ark. 576, 37 L. R. A. 374, the Court said in discussing the value of property:

> "The value of the property results from the use to which it is put and varies with the profitableness of that use present and prospective actual and anticipated."

Point IX. Cost is not Synonymous with Market Value.

The Commissioner arbitrarily used cost as to the value of the insurance policies March 1, 1913. The premiums were fully paid on the policies by May 19, 1908, almost five years before March 1, 1913. As we understand the rule, cost is no evidence of value independent of other and supporting evidence. This is especially true where the property has been acquired remotely from the time of valuation. See Schoet v. Oriental Storage Company, 155 Wisconsin, 121.

Point X. Forfeited Value of the Insurance Policies March 1, 1913, is no Evidence of Fair Value.

The petitioner contends that the March 1, 1913, value of respondent's policies was their loan value plus the then accumulated dividends and in support of his contention quotes from the testimony of Mr. Bowerman, Assistant Actuary of the New York Life Insurance Company, who testified (R., p. 55) that the respondent could have borrowed on his policies on March 1, 1913, $74,600.00, and if the loan had not been paid the policies would have lapsed to the company and the respondent woud have forfeited his dividends.

If respondent had borrowed the maximum loan value of his policies, to wit, $74,600.00, at five per cent (R., p. 16), the interest thereon to maturity would have been approximately $22,380.00, which would have left $3,020.00 plus accumulated dividends at maturity. These were continuing contracts and sums received on forfeiture at any date are no fair evidence of value. He would have incurred forfeiture penalties if he had surrendered the policies on any date before maturity. These facts demonstrate the illogical and senseless method the defendant uses to determine March 1, 1913, value.

Point XI. Criticism of Method used by Lower Court in Determining March 1, 1913 Value.

Judge Dawson determined the March 1, 1913, value of the policies in the following manner as stated in his opinion:

> "Under all the circumstances, I think it is fair to both the Government and the plaintiff to fix the value of what the plaintiff could at that date have reasonably anticipated they would have been worth on the 19th of May, 1919, under the fourth option heretofore referred to, arriving at the then present value by the application of a four per cent interest rate, compounded annually. As I have heretofore indicated, I think the plaintiff on March 1, 1913, could reasonably have anticipated that at the end of the accumulation period he would receive at least $19,428.57 of accumulations, and in addition thereto the face value of the policies, or a total of $119,428.57. The present value of this sum on March 1, 1913, at four per cent interest compounded annually would be $93,587.81. This amount, I think, should be treated as the fair value of the plaintiff's two policy contracts on March 1, 1913. Deducting this sum from $120,797.00, the amount actually received by the plaintiff upon the surrender of his policies at the accumulation period, would result in a taxable gain of $27,209.19. Of this sum $20,797 was paid out of earned surplus, and is therefore taxable as dividends, which $6,412.19 thereof would be subject to both normal and surtax" (R., P. 28).

We think the error committed by the lower court lies in the fact that he discounted the anticipated income from the policies four per cent from date of maturity to March 1, 1913. This was undoubtedly on the assumption that from March 1, 1913, to date of maturity there would be no further accumulated dividends to be allocated to these policies. Based on the previous experience of the Company as testified to by Mr. Bowerman (R., p. 50), it could reasonably be anticipated that the earnings subsequent to March 1, 1913, would be greater than those prior to March 1, 1913. If the respondent could have sold his contract to a purchaser who was willing but not compelled to buy, such a purchaser could reasonably have anticipated that future accumulations would more than offset four per cent interest on the purchase price and would not have discounted the sum expected to be realized.

Point XII. Fair Method of Valuation.

On March 1, 1913, the respondent knew he would get, if living on May 19, 1919, $100,000.00 in cash and he also knew that there was already an ascertained surplus of $13,600.00 on the two policies with a reasonable expectation of the surplus increasing before maturity. We think the fair value of the two policies was $113,600.00, which, deducted from the sum received on surrender, to wit, $120,797.00, leaves a profit of $7,197.00, which is the entire sum, if any, that should be taxed.

The policyholders in a mutual life insurance company have the same status as a stockholder in a corpo-

ration. In valuing the stock of a corporation probable future earnings are an important factor, which is equally true in valuing an insurance policy. Chicago Railway Equipment Company v. Blair, 20 Fed. (2d), 10; United States v. Guggenheim Exploration Company, 238 Fed. 231.

CONCLUSION.

Respondent respectfully contends—

First. That the sums received by the respondent on the surrender of the insurance policies did not constitute income as provided in the Sixteenth Amendment.

Second. Using total premiums paid as the March 1, 1913, value of these policies is arbitrary and no proof of correct value.

Third. That the sums respondent would have received on the forfeiture of the policies March 1, 1913, are no evidence of March 1, 1913, value.

Fourth. That the face value of the policies plus provisionally ascertained dividends is the best evidence of March 1, 1913, value, if any.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 481.

ROBERT H. LUCAS, Collector of Internal Revenue for the District of Kentucky, - - - - - Petitioner,

vs.

A. J. A. ALEXANDER, - - - - - - Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

SUPPLEMENTAL BRIEF FOR RESPONDENT.

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WESTERFIELD-BOOTS COMPANY, INCORPORATED, LOUISVILLE, KY.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 481.

ROBERT H. LUCAS, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF KENTUCKY, - - - - - - - - *Petitioner,*

vs.

A. J. A. ALEXANDER, - - - - - *Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

SUPPLEMENTAL BRIEF FOR RESPONDENT.

We did not have a copy of petitioner's brief at the time respondent's brief was written and desire to reply to two points raised, which were not originally covered.

I.

The Bankruptcy Act is not analogous to the Revenue Law and the fact that cash surrender value is the only amount passing to the trustee is not at all indicative that value under the Income Tax Law is no more than cash surrender.

Section 70 (a) of the Bankruptcy Act (Act of July 1, 1898, C. 541, 30 Stat. 544, 565) U. S. C. A. T. 11,

Section 110, specifically provides for the exclusion of life insurance policies on the payment of the cash surrender value to the trustee. Said section is as follows:

> "When any bankrupt shall have any insurance policy which has a cash surrender value payable to himself, his estate, or personal representative, he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same, pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankruptcy proceedings, otherwise the policy shall pass to the trustee as assets."

Unlike the Bankruptcy Act, the Revenue Act does not specifically provide for taxing the proceeds of insurance policies, where the premiums are paid before March 1, 1913, and surrendered subsequently.

In our original brief, we did not take up valuation of insurance policies of bankrupts, because of the provisions peculiar to the Bankruptcy Act. However, the courts have said, in bankruptcy cases, in construing policies with postponed dividend features, that such were property rights and susceptible to valuation. *In re* Slingluff, 106 Fed. 154, the Court said:

> "The endowment feature is obviously in the nature of a savings fund, in which the assured and his assigns are interested, but the beneficiary is not. So far as the assured is concerned, the endow-

ment feature is the accumulating, by depositing with the company the annual premiums, of a sum to be paid to him in his lifetime if he survives the endowment period. * * *

"It is, I think, apparent that such a policy may have no surrender value, and yet have a very large actual value, which can be secured to the bankrupt's creditors without in any manner affecting the contingent interest which it was contemplated should be secured to the beneficiaries. There would seem to be no reason why the deposits in a life insurance company to secure a sum payable to the assured at a given date, if he should be then alive, should be treated differently from a similar contract with a savings bank or building association."

In *In re* Willing, 113 Fed. 194, the Court, referring to deferred dividend policies, said:

"By the terms of the policy he was entitled to receive at the end of the tontine period the cash payment stipulated in the contract. That is a vested contract right, contingent only upon his surviving the tontine period. The right is valuable, increasing in value with each successive payment of premium. The policy, technically, had not a 'surrender value,' within the meaning of the proviso; but it had an actual value, and that valuable right was right of property existing in the bankrupt. * * *

"The contract in question gives to the bankrupt the right to receive at a certain date a specified sum of money, contingent upon his surviving to that date. This is a vested right of property existing in the bankrupt, which passes to the trustee."

See also the cases of Patridge v. Andrews, 191 Fed. 328, Mutual Life Insurance Company v. Smith, 184 Fed. 2; *In re* Churchill, 198 Fed. 712.

The bankruptcy courts have not encountered any insurmountable difficulties in determining the value of deferred dividend and endowment insurance policies passing to the trustee.

The authorities do not support the statement made on page 7 of petitioner's brief:

> "It was the purpose of the Bankruptcy Act to give the full value of the policy to creditors and the cash surrender value was specified as the equivalent of the full value."

On the other hand, the authorities herein cited show the contrary.

II.

The probability of the respondent dying before the maturity of the policies did not make them have only a speculative value March 1, 1913.

The sole argument made by the petitioner against the method of the District Court in determining value March 1, 1913, is that the probability of respondent living to the maturity of the policies was contingent and this gave to them only a speculative value March 1, 1913, and no market value.

Life is as certain as death and the probability of the respondent dying between March 1, 1913, and May, 1919, were remote. According to the life tables, he would have lived many years after 1919.

Thousands of cases are tried in the courts of the United States every year seeking to recover damages for death and in almost every one of them the measure of damages is determined by the expected life of the deceased, based on his earning capacity. Present worth of curtesy and dower is being found in hundreds of courts always based on the expected life of the persons interested. Present worth of annuities is often determined in courts, and in income and inheritance tax cases. The whole principle of life insurance is based on the certainty of life, which certainty takes such contracts out of the field of hazard and places them on substantially the same basis as ordinary contracts. No healthy individual would sell an annuity on a ten-year purchase, unless in dire extremity, not in fear of death.

The Treasury Department has used life tables in determining the present value of contingent remainder interest on the sale of real estate. In I. T. 2076, C. B. III-2, in pointing out the method for determining the value of a life estate, the Income Tax Unit, said:

> "The value of B's life estate for the purpose of computing gain or loss from its sale should be ascertained by the following tests:
>
> (1) An annuity based upon income at the rate of 4 percent per annum of the value of the fee on the date of his acquisition of the life estate in 190— should be computed. For this purpose Table A, appearing on page 18 of Regulations 63, revised, should be used to determine the then worth of $1 payable at the end of each year during the life of the taxpayer, which multiplied by the amount

> which is shown to be the annual income based upon a 4 percent return as hereinbefore stated will give the value of the taxpayer's life estate at the date of acquisition."

The Board of Tax Appeals also followed the same method in valuing a life annuity in the appeal of John C. Moore Corporation, 3 B. T. A. 430. In the case of Simpson, *et al.*, v. United States, 252 U. S. 547, this Court, in pointing out the method to be used in valuing a contingent remainder interest, said:

> "The objection is not to the particular table that was used but to the use of any such table at all—to the method. Such tables, indeed the precise table which was made the basis of the one used by the collector, had been resorted to for many years prior to 1889 by courts, Legislatures, and insurance companies for the purpose of determining the present value of future contingent interests in property, and we take judicial notice of the fact that at the time this tax was collected 4 percent was very generally assumed to be the fair value or earning power of money safely invested. Both the method and the rate adopted in this case have been assumed by this court, without discussion, as proper in computing the amount of taxes to be collected under this War Revenue Act."

The universal method to determine the present value of contingent and vested life estates is to assume that the persons involved will live their expectancy according to the mortuary tables and reduce the capital sum to its present worth at the period of expected receipt.

Grove versus Youell, 110 Mich. 285, 33 L. R. A. 519, 137 A. L. R. 663; Jordan versus Benwood, 42 W. V. A. 312, 36 L. R. A. 519.

CONCLUSION.

We respectfully submit that the petitioner presents no reason in his brief for a reversal of the Circuit or District Court.

All of which is respectfully submitted.

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SUPREME COURT OF THE UNITED STATES.

No. 481.—October Term, 1928.

Robert H. Lucas, Collector of Internal Revenue for the District of Kentucky, Petitioner,
vs.
Kate Halloway Alexander, et al., etc.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[May 20, 1929.]

Mr. Justice Stone delivered the opinion of the Court.

This case is here on certiorari, granted November 19, 1928, — U. S. —, to review a judgment of the Court of Appeals for the Sixth Circuit, 27 F. (2d) 237, affirming a judgment of the District Court for Western Kentucky, 21 F. (2d) 68, allowing recovery from the Collector of Internal Revenue of federal income taxes alleged to have been illegally exacted.

On May 19, 1899, respondents' testator procured two life insurance policies for $50,000 each upon his own life and payable to his estate. On May 19, 1908, they became fully paid up policies, upon the payment of the last of ten annual premiums aggregating, for both policies, $78,100. Each policy stipulated that in the event of death within ten years the amount payable should be $50,000 and, from the eleventh to the twentieth year inclusive, an annually increasing amount ranging from $50,700 in the eleventh year to $72,150 in the twentieth year. The death benefit on each policy during the year ending May 19, 1913, was $59,300. The policies participated in the surplus of the company and "dividends" properly allocable to each were set aside or ascertainable on its books each year, but were payable only at the end of the tontine period of twenty years and only to holders of policies still in force at that time.

The insured was given an option at the end of the period of receiving on each policy the sum of $50,000 "and in addition the cash dividend then apportioned by the company." The insured elected to exercise this option May 19, 1919, receiving as proceeds of the two policies $120,797, representing $100,000 face value plus

$20,797 dividends. The gain to him over his total premium expenditure was thus $42,697. The Commissioner assessed this amount as taxable income under the Revenue Act of 1918, c. 18, 40 Stat. 1057.

Both the district court and the court of appeals thought that, under § 202a(1) of the Act, only so much of the proceeds of the policies as exceeded their value on March 1, 1913, was subject to tax. They found that the amount provisionally set aside by the company as surplus accumulations applicable to the two policies on that date was $13,600, and that it was then evident that the rate of accumulation, although not certain, would probably be greater during the later years of the tontine period than before March 1, 1913. Even at the same rate, the accumulation at the end of the period would amount to $19,428.57. Both courts, therefore, concluded that the insured might reasonably have anticipated that the policies would have been worth on their maturity date, if then in force, their face value plus the anticipated accumulations, or a total for both policies of $119,428.57. Since, under the sliding scale, the death benefits would have been even proportionately larger had the insured died before the end of the period, they decided that the combined value of the policies on March 1, 1913, was the smaller amount discounted at the rate of 4% compounded annually to that date, or $93,587.81. The taxable gain on the policies, accordingly, was taken to be the difference between this amount and the actual proceeds of the policies, or $27,209.19. A recovery was allowed of the difference between the tax as assessed and that as computed on the gain after March 1, 1913, so ascertained.

As respondents did not ask certiorari, we may disregard their argument that the judgment below was erroneous in that the proceeds of an insurance policy paid to the insured are not taxable income, except as the determination of that question may be involved in passing upon the assignments of error of petitioner. *See Federal Trade Commission* v. *Pacific Paper Ass'n*, 273 U. S. 52, 66.

By the expenditure of $78,100 in premiums, the insured secured a return of $120,797, resulting in an economic and realized money gain to him of $42,697. The question of liability for the tax on this gain is different from that mooted by counsel, but not decided, in *United States* v. *Supplee-Biddle Hardware Co.*, 265

U. S. 189, 194, which was whether insurance upon the life of a corporate officer, paid at his death to the corporation, could be constitutionally subjected to a tax on income. Here the amount paid was not a death benefit or in the nature of a gift to a beneficiary and was in no sense an indemnity for, or repayment of, an economic loss suffered by the insured, but was a profit or gain upon his premium investment, and would seem to be plainly embraced within the provisions of § 213 taxing "gains or profits and income derived from any source whatever" and not exempted as such from tax by any other provision of the Act. See *Penn. Mutual Co.* v. *Lederer*, 252 U. S. 523, 532, 534; *Eisner* v. *Macomber*, 252 U. S. 189, 207; *Merchants' Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 518.

But of this total gain received by the insured, a part is attributable to and accrued during the period before the effective date of the Sixteenth Amendment (February 25, 1913), and of the first law taxing the income of individuals (March 1, 1913), and hence, for income tax purposes, must be deemed an accretion to capital not taxable by the income tax acts enacted under the Sixteenth Amendment. See *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, 334; cf. *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179; *Lynch* v. *Turrish*, 247 U. S. 221. Whether or not such accretions may be constitutionality subjected to tax, we have no occasion to decide. The present Act, at least, does not attempt it. But the question presented necessarily involves a determination of what part of the total gain received by the taxpayer accrued to him after March 1, 1913. In answering it, provisions of the taxing statute enacted as aids in arriving at the answer must be construed with an eye to possible constitutional limitations so as to avoid doubts as to its validity. *United States* v. *Delaware & Hudson Co.*, 213 U. S. 366, 407, 408; *United States* v. *Standard Brewery*, 251 U. S. 210, 220; *Texas* v. *Eastern Texas R. R. Co.*, 258 U. S. 204, 217; *Bratton* v. *Chandler*, 260 U. S. 110, 114; *Panama R. R. Co.* v. *Johnson*, 264 U. S. 375, 390.

Section 202 of the Revenue Act of 1918 provides:

"(A) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal or mixed, the basis shall be:

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date."

The Government insists that the policies, being non-assignable except to persons having an insurable interest in the life of the insured, had no market price and their combined value as of March 1, 1913 did not exceed their loan or cash surrender value on that date, which alone could be realized on them, of $74,600, Regulations 45 (1920) Art. 87, and that any greater value assigned to them as of that date must be rejected as contingent and speculative. But in view of the provisions of § 213b(2) of the Act, see Regulations 45 (1920) Art. 72(b), exempting from taxation the return of premiums on the maturity of the policy, it concedes that the taxable gain of the insured may be taken at the amount, fixed by the commissioner, by which the proceeds of the policies exceeded $78,100, the total premiums paid.

Plainly, in the present case, the $42,697 gained over premium cost of the two policies, which accrued to the taxpayer through a period of twenty years, did not all accrue in the six years following March 1, 1913. If the value on that date, for the purpose of ascertaining taxable gain, was greater than the total premium expenditure which had been completed more than four years before, there is no reasonable basis for determining the taxable gain which accrued after March 1, 1913, by deducting from the total amount received the total premium payments.

Nor can we accept the contention of the Government that the value of the policies on March 1, 1913, did not exceed their loan value as of that date. The purpose of ascertaining the value of the taxpayer's property on March 1, 1913 is, as § 202 states, to measure that part of his total gain which has arisen or accrued after the enactment of any of the statutes taxing income and thus to arrive at his gain which may be taxed as income. *Lynch* v. *Turrish*, *supra*. Value as of that date may be disregarded unless it serves that purpose. *United States* v. *Flannery*, 268 U. S. 98; *Goodrich* v. *Edwards*, 255 U. S. 527; *Walsh* v. *Brewster*, 255 U. S. 536.

Under the statute, market price of the taxpayer's property on that date, where ascertainable, may be resorted to as generally a sufficiently definite and trustworthy gauge of the gain which has later accrued. But where the property has no market value, the statute must be interpreted in the light of its purpose to ascertain taxable gains accruing since March 1, 1913. Hence, in such a

case, its fair value on the critical date is not necessarily what might then have been realized upon it by a forced liquidation by accepting the unfavorable loan or cash surrender value. Having in mind the purpose of the statute, we think it must be taken rather to be that part of the amount actually realized by the taxpayer which, by the use of appropriate accounting methods, can fairly be said to have accrued before March 1, 1913—its value then as compared with the value in fact later realized by the taxpayer taken as a standard.

In applying § 202a(1) to an insurance policy having no market value, we are not required either by circumstances or any positive provision of statute to determine its value on March 1, 1913 by making a prediction as of that time based upon an estimate of future possibilities, as is the case in valuing for purposes of inheritance tax an interest of uncertain duration passing at the death of the testator. See *Ithaca Trust Co.* v. *United States*, No. 267, October Term, 1928, — U. S. —. There the value as of the date of death is the very thing taxed and can usually be determined only by speculation as to future events. Here, 1913 value is at most merely a method of allocating a known income to the periods in which it actually accrued. It is never necessary to speculate, as did the court below, as to what might later be realized from his property by the taxpayer, nor as to what might have been realized if, on March 1, 1913, he had made some forced disposition of the property which would have precluded any taxable gain. For the necessity of ascertaining value as of March 1, 1913, can never arise until some later date when income has been produced by converting the property into money or money's worth and the amount actually realized is known, and then, as we have said, only for the purpose of apportioning the total gain which has accrued between the periods before and after March 1, 1913.

It is familiar knowledge that the source of dividend accumulations upon insurance policies is interest upon investments of the company and savings effected from estimated future expenses and from death payments covered by premiums, with appropriate "loadings" to give a margin of safety, which the policy holders have paid. In accordance with the usual practice of life insurance companies, under the system of accounting employed by the insurer in the present case, the amount of reserve set aside by the company to meet its policy liability and dividend accumu-

lations provisionally apportioned to each policy was ascertained or ascertainable on the books of the company at the end of each year. During the policy year which included March 1, 1913, the insurance reserve liability thus ascertained on each of the present policies was $40,600 and the dividend accumulation on each, which both courts below found had accrued on March 1, 1913, was $6,800, making a total of reserve and accumulations applicable to each policy of $47,400. These items with subsequent annual additions totaled at the maturity of each policy, for the former $50,000 and for the latter $10,398.50 which, taken together, made up the total payment received by the taxpayer on each policy. They constitute a complete record and determination of the actual economic gain annually accruing upon the policies which was ultimately realized by the taxpayer and they provide an adequate basis for ascertaining the proportion of the total value realized which had accrued on March 1, 1913. The sum of the insurance reserve liability and the dividend accumulations provisionally apportioned to the two policies on March 1, 1913, their accrued value on that date, was $94,800. As that valuation is larger than that found by either of the lower courts and is supported by reliable data, we may, in the absence of other evidence, accept it as sufficiently establishing that the value found below was not more than that required to be ascertained by the statute and so did not prejudice the rights of petitioner. It is unnecessary to consider the question mooted whether upon other evidence, not here presented, a larger value as of March 1, 1913, might have been found.

The court below, by discounting the total estimated value of the policies at their maturity at 4%, arrived at a rough approximation of their accrued value on that date. This method, however, did not ascertain that value or the taxable gain with accuracy, since it was based on an assumed instead of the actual value of the policies at maturity. It discounted the assumed value at a flat rate of interest instead of at that actually earned, and it left out of account savings from estimated expenses and death losses which, as well as actual interest earned, were taken into account in determining dividend accumulations annually ascertained and credited to the policies on the books of the company. But, as the accuracy of the computation is not questioned here, and as it gave a result of which petitioner cannot complain, the judgment will be

Affirmed.